

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT of 1934
Rel. No. 60772 / October 2, 2009

In the Matter of)
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)
FANNIE MAE SECURITIES)
LITIGATION, Civ. Action No. 04-01639)
(D.D.C.))
)
)

ORDER DENYING PETITION FOR REVIEW

Pursuant to Rule 431(b)(2) of the Rules of Practice,¹ it is ORDERED that the Petition for Review filed by Ohio Public Employees Retirement System and State Teachers Retirement System of Ohio (collectively, “lead plaintiffs”), received by the Secretary on August 31, 2009, is hereby denied.

BACKGROUND

On June 24, 2008, lead plaintiffs in the *Fannie Mae Securities Litigation*, Civ. Action No. 04-01639 (D.D.C.), to which the Commission is not a party, served a deposition subpoena on former Commission Chief Accountant Donald Nicolaisen. On July 10, 2008, consistent with the Commission’s regulations applicable to subpoenas issued to present or former Commission employees in cases in which the Commission is not a party,² Commission staff wrote to lead plaintiffs’ counsel apprising them of those regulations and requesting further information to clarify the intended scope of the deposition and the anticipated relevance of the testimony to the litigation.

Lead plaintiffs’ counsel did not respond to staff’s letter until June 22, 2009. In that response, counsel explained their reason for requesting Mr. Nicolaisen’s testimony as follows:

¹ 17 CFR 201.431(b)(2).

²See 17 C.F.R. 200.735-3(b)(7). These regulations, which are comparable to those of other federal agencies, were adopted in light of the Supreme Court’s decision in United States ex rel. Touhy v. Ragen, 340 U.S. 462, 467-69 (1951), and thus are referred to as Touhy regulations.

[T]he SEC, through its Office of the Chief Accountant, determined that Fannie Mae's accounting practices did not comply in material respects with the accounting requirements of Financial Accounting Standards Board Statements 91 and 133. The complaint further alleges that Mr. Nicolaisen . . . testified before Congress on February 9, 2005, that Fannie Mae's practices with respect to FAS 133 accounting was not "even on the page" of compliance, was outside professional accounting standards and this conclusion was not "just a matter of interpretive judgment where two people could've come to varying conclusions." Mr. Nicolaisen further testified that the rules relating to FAS 133 "are not overly complex. I think those rules are clear." He also testified that he believes that other companies were complying with Statements 91 and 133.

. . . Mr. Nicolaisen's **public statements** and the GAAP violations found by the SEC . . . are squarely relevant to the central claims and defenses in this case.

On August 14, 2009, acting pursuant to delegated authority, the Commission's Associate General Counsel ("AGC") for Litigation and Administrative Practice issued a decision denying authorization for Mr. Nicolaisen to provide the requested deposition testimony. The AGC stated that in making this decision he considered the "desirability in the public interest" of the proposed testimony, "including whether it would invade the Commission's privileges and whether it would impose undue harm, burden, or expense on the witness or the Commission. See Federal Rule of Civil Procedure 45(c)." The AGC first focused upon the burden that would befall the Commission if Mr. Nicolaisen were to testify. He cited the extensive case law that government agencies should ordinarily be protected from the burden of producing employees for testimony in private actions so that the agencies can focus their resources on their statutory duties. See, e.g., Watts v. SEC, 482 F.3d 501, 509-10 (D.C.Cir. 2007) (recognizing that discovery must accommodate "the government's serious and legitimate concern that its employee resources not be commandeered into service by private litigants to the detriment of the smooth functioning of government operations."). He stated that counsel has not materially distinguished this case from the many others in which litigants would like Commission staff to testify.

Then, responding directly to lead plaintiffs' reason for requesting the testimony, the AGC stated:

[B]ecause you have Mr. Nicolaisen's statement to Fannie Mae and his Congressional testimony, you have significant information about Mr. Nicolaisen's views. It is not clear how further details about those views or how they were reached is relevant to your case as Mr. Nicolaisen's after-the-fact assessment does not and cannot take the place of the litigation process in which you are involved. Mr. Nicolaisen's views and opinions do not appear to qualify as evidence, and it is not clear how they could lead to the discovery of admissible evidence. . . . This is especially true as

Mr. Nicolaisen did not have access to all the documents and information gathered and obtained in the litigation and, in fact, had only a relatively limited universe of documents and information provided by Fannie Mae and OFHEO. Moreover, staff views, such as Mr. Nicolaisen's, do not reveal any SEC positions or practices. *See* 17 C.F.R. 202.1(d).³

The AGC further stated that Mr. Nicolaisen's status as a former employee does not remove the burden upon the Commission, as "resources still have to be used to prepare and represent him. Given the broad scope of opinion testimony you seek to elicit from Mr. Nicolaisen, the privilege issues, and the passage of time since he issued his statement and testified before Congress, this would require the Commission to devote a substantial amount of its resources to your private action as opposed to the Commission's work."

In addition to the burden upon the Commission from the testimony sought from Mr. Nicolaisen, the AGC in reaching his decision also relied upon the likelihood that the testimony would invade the Commission's privileges. He focused in particular upon the Commission's deliberative process privilege, and observed: "Testimony regarding the bases for Mr. Nicolaisen's conclusions as to Fannie Mae's accounting practices and policies with respect to SFAS 91 and 133, the scope and nature of the documents he reviewed and relied upon in reaching his conclusions, and any communications he had with other federal government regulators before he issued his December 15, 2004 statement would be protected because his testimony would reflect the deliberations that led to his statement."

Finally, with respect to lead plaintiffs' assertion that Mr. Nicolaisen's testimony would be in the public interest given the size and scope of the litigation, the AGC noted that the Commission previously obtained and paid out in a fair fund distribution a \$350 million civil penalty from Fannie Mae. He also stated that the large scope of the case should assure that plaintiffs have the resources to retain their own experts.

THE PETITION FOR REVIEW

Lead plaintiffs advance four arguments why we should reverse the AGC's decision and authorize Mr. Nicolaisen's testimony.

First, lead plaintiffs proclaim that "this is a case of unparalleled public interest." While acknowledging that Fannie Mae already has paid significant fines, and victims have received fair fund distributions, lead plaintiffs declare "that amount represents only a small portion of the billions of dollars of damages suffered by investors."

³ The AGC noted that qualifying Mr. Nicolaisen as an expert witness appears to be the only way his testimony could be admissible, but it would be inappropriate for lead plaintiffs to compel Mr. Nicolaisen to opine as an expert instead of retaining their own expert.

Second, lead plaintiffs state that Mr. Nicolaisen’s testimony is sought as a fact witness, not to provide opinion or expert testimony. They state that the testimony is sought “for the purpose of better understanding the review process and factual basis for why the Chief Accountant of the SEC would believe that Fannie Mae’s accounting was not ‘even on the page’ of compliance, which in turn is highly relevant to the level of scienter the defendants had of such non-compliance.” They also declare that Mr. Nicolaisen “or other SEC officials . . . participated in *numerous* meetings and communications *with Fannie Mae* where Fannie Mae’s accounting practices were discussed.”

Third, lead plaintiffs contend the burden on the Commission from Mr. Nicolaisen’s deposition would be modest, in that he is a former, not a present, Commission employee and a discovery protocol governs depositions in the case.

Fourth, lead plaintiffs argue that Mr. Nicolaisen’s testimony would not be privileged and, even if it were, the Commission’s assertion of the deliberative process privilege could be overcome by a showing of need, which lead plaintiffs contend could be made in this situation.

ANALYSIS

Under our Rules of Practice, the Commission has discretion to decline to review lead plaintiffs’ Petition for Review. See 17 C.F.R. 201.431(b)(2).⁴ We exercise our discretion to review the Petition, and deny it.

In that this case arises within the District of Columbia Circuit, and in light of the decision of the Court of Appeals in Watts v. SEC, supra, 480 F.3d 501, 508-10, we analyze lead plaintiffs’ Petition in accordance with the standards embodied in Rule 45(c) of the Federal Rules of Civil Procedure.⁵ Specifically, we look primarily to whether

⁴ In determining whether to grant review, the Commission considers whether a prejudicial error was committed in the conduct of a proceeding, or a reviewable decision embodies a finding or conclusion of material fact that is clearly erroneous, or an erroneous conclusion of law, or an exercise of discretion or important decision of law or policy that the Commission should review. 17 C.F.R. 201.411(b)(2).

⁵There appears to be a split among the circuits concerning whether judicial review of a federal agency’s decision to decline to authorize testimony pursuant to its Touhy regulations is governed by the Administrative Procedure Act or the Federal Rules of Civil Procedure. Several courts have held that the Administrative Procedure Act’s arbitrary and capricious standard should apply to judicial review of agency decisions regarding testimony subpoenas. See In re SEC ex rel. Glotzer, 374 F.3d 184 (2d Cir. 2004); COMSAT Corp. v. Nat’l Science Found., 190 F.3d 269, 274 (4th Cir. 1999); Edwards v. United States Dep’t of Justice, 43 F.3d 312, 314 (7th Cir. 1994); Moore v. Armour Pharmaceutical Co., 927 F.2d 1194, 1198 (11th Cir. 1991); Davis Enterprises v. EPA, 877 F.2d 1181, 1186 (3d Cir. 1989). In a footnote in Watts, 482 F.3d at 508 n.*, the District of Columbia Circuit stated that the APA standard does not apply to review of an agency’s

authorizing Mr. Nicolaisen's deposition would cause undue burden to the Commission, whether that testimony likely would invade the Commission's privileges, and whether the testimony would consist of expert opinion, rather than fact testimony.⁶ We take into consideration the AGC's decision, and his reasoning, but accord it no deference, and engage in de novo review.

In sum, we are unpersuaded by lead plaintiffs' arguments and conclude that the testimony they seek to obtain from Mr. Nicolaisen as a fact witness would constitute, in large part, expert opinion testimony and, to any extent not so, would be largely protected by the Commission's deliberative process privilege. Under the circumstances present here, authorization of Mr. Nicolaisen's testimony would unduly burden the Commission.

At the outset, we address lead plaintiffs' first argument -- that Mr. Nicolaisen's testimony would serve the public interest. In support of this position, lead plaintiffs state that "over 30 million retired public service employees were harmed by the fraud alleged in the Complaint" and the penalty already paid by Fannie Mae "represents only a small portion of the billions of dollars of damages suffered by investors." The Commission, the agency principally responsible for the administration and enforcement of the federal securities laws, has long expressed the view that legitimate private actions under those laws serve an important role. They work to compensate investors who have been harmed by securities law violations and, as the Supreme Court has repeatedly recognized, they "provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" Bateman, Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985), quoting J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964); see Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975).

At the same time, however, we agree with the AGC that:

The burden on the Commission that would result if it allowed current or former staff to be deposed whenever a litigant in private litigation sought a Commission witness to testify would be significant. The federal securities laws and accounting principles are at issue in countless private actions and, in many of those, one or more of the parties would be interested in obtaining testimony from current or former Commission staff regarding views staff may have expressed regarding compliance with the federal

decision not to authorize staff to testify in response to a subpoena served in a federal case to which the Commission is not a party. See also Exxon Shipping Co. v. U.S. Dep't of Interior, 34 F.3d 774, 778-79 (9th Cir. 1994)(declining to hold that federal courts cannot compel federal officers to give factual testimony).

⁶ Fed.R.Civ.P. 45(c)(1) requires a "party or an attorney responsible for the issuance and service of a subpoena [to] . . . take reasonable steps to avoid imposing undue burden or expense on a person subject to the subpoena." A court may quash or modify the subpoena if it, inter alia, "subjects a person to undue burden" or "requires disclosure of privileged or other protected matter and no exception or waiver applies."

securities laws or with accounting principles. Every attorney in the Commission's Division of Corporation Finance who issues a comment letter and every accountant in the Commission's Office of Chief Accountant who provides staff accounting guidance is a potential witness.

Ordinarily, the Commission should be shielded from this burden so that it can focus its limited resources on its statutory duties. See COMSAT Corp. v. National Science Found., 190 F.3d 269, 277-78 (4th Cir. 1999) ("As an agency official must, NSF's counsel also considered whether the public interest and the agency's taxpayer-funded mission would be furthered by compliance."); Johnson v. Bryco Arms, 226 F.R.D. 441 (E.D.N.Y. 2005) (quashing deposition subpoenas to ATF personnel where ATF was not a party to the case and had provided documents from an investigation conducted by ATF that were relevant to case); Moran v. Pfizer, No. 99 civ 9969, 2000 WL 1099884, at * 3 (S.D.N.Y. Aug. 4, 2000) ("Courts have regularly held that the public interest in insuring that agency employees spend their time doing the agency's work is a valid reason to decline to comply with a subpoena."); Moore v. Armour Pharmaceutical Co., 129 F.R.D. 551, 556 (N.D. Ga. 1990) (noting that courts routinely consider "the policy of preserving the resources of governmental agencies from the flood of private litigation" in reviewing decisions not to authorize depositions); Alex v. Jasper Wyman & Son, 115 F.R.D. 156, 158-59 (D. Me. 1986) (noting "important public policy favoring the conservation of government resources and the protection of orderly government operations" in explaining why undue burden analysis allowed court to prohibit taking of deposition altogether). Accordingly, in evaluating whether this is a special case that justifies authorizing Mr. Nicolaisen to testify, we must consider more than the size and scope of the litigation and evaluate his connection, if any, to the potentially relevant facts and circumstances and the nature of the testimony that lead plaintiffs seek to obtain from him.

This analysis requires consideration of lead plaintiffs' second argument -- that they intend Mr. Nicolaisen only to testify as a fact witness, and not to provide opinion or expert testimony. It seems fair to conclude that lead plaintiffs' position on this subject has shifted somewhat. We note that lead plaintiffs waited almost a year to respond to staff's request for information about the questions that would be asked at the deposition and, when lead plaintiffs eventually did respond, they did not set forth any of the proposed questions as staff had requested they do. Instead, lead plaintiffs indicated that they were seeking to discover the basis for statements of Mr. Nicolaisen that Fannie Mae's accounting was not consistent with FASB Standards 91 and 133. On that subject, we agree with the AGC not only that lead plaintiffs already have Mr. Nicolaisen's statement to Fannie Mae and his congressional testimony about the accounting standards, but also that any further details Mr. Nicolaisen might be able to provide about his after-the-fact accounting assessment cannot take the place of the litigation process, especially as Mr. Nicolaisen has stated that his opinion was based upon a limited universe of documents.

Moreover, any views expressed by Mr. Nicolaisen about Fannie Mae's accounting cannot be attributed to the Commission. Mr. Nicolaisen emphasized this point in his

congressional testimony: “The views I express today . . . are my personal views and my testimony has not been reviewed or approved by the Commission.” Testimony of Donald T. Nicolaisen, House Committee on Financial Services, Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises (Feb. 9, 2005)(available at <http://financialservices.house.gov/archive/hearings.asp@formmode=detail&hearing=346.html>). Under the Commission’s regulations, staff opinions “do not constitute an official expression of the [Commission’s] views.” 17 C.F.R. 202.1(d). Statements of Commission staff are not statements of the Commission, which acts through its Chairman and Commissioners. See, e.g., SEC v. National Student Mktg. Corp., 68 F.R.D. 157, 160 (D.D.C. 1975); Pennzoil Corp. v. DOE, 680 F.2d 156, 161-62 (Temp. Emer. Ct. App. 1982). The Commission expresses policy through issuance of rules and regulations. 17 C.F.R. 202.1. Staff views do not reveal or constitute Commission positions or practices.

Further, we are hardpressed to understand how any testimony Mr. Nicolaisen might provide about his personal views concerning the accounting standards and Fannie Mae’s compliance, or lack thereof, with them would constitute anything other than his opinion, which ordinarily would not be admissible unless he were to be qualified as an expert. Since lead plaintiffs aver they do not seek expert testimony from Mr. Nicolaisen, and the Commission has not been asked to authorize such testimony, it appears his views would not be evidentiary, as the AGC noted (citing Fed. R. Evid. 701). Moreover, as lead plaintiffs already have the benefit of Mr. Nicolaisen’s views in the form of his congressional testimony and statement to Fannie Mae, there is no reasonable likelihood that his deposition concerning those views would lead to the discovery of admissible evidence.

Lead plaintiffs further aver that they need Mr. Nicolaisen’s testimony because he, “or other SEC officials,” participated in meetings where Fannie Mae’s accounting practices were discussed. This appears to be a new argument, as it was not set forth in lead plaintiffs’ June 22, 2009 letter to Commission staff, and thus was not addressed in the AGC’s decision. We note that, as a basis for this argument, lead plaintiffs have included as Attachment 3 to their Petition documents referring to a total of four meetings or conversations. From these documents, it appears Mr. Nicolaisen may have been present on only one of these occasions and, in that instance, he was one of some 45 persons to sign in for a meeting that did not include any personnel from Fannie Mae. All four of the meetings/conversations referenced by lead plaintiffs appear to have occurred in the last quarter of 2004, after the events underlying Fannie Mae’s accounting errors. The documents included in Attachment 3 do not indicate the subject of any of the meetings/conversations. On the evidence before us, we cannot conclude there is any particular need for Mr. Nicolaisen to testify to his recollection, if any, about these meetings/conversations, especially as persons outside the Commission having greater involvement in the private litigation should be available to testify about these events and there is no indication in the documents that Fannie Mae personnel participated in them.

Lead plaintiffs’ third argument is that the burden on the Commission were Mr. Nicolaisen to testify would not be substantial, because he is not a current Commission employee. Lead plaintiffs appear to overlook the need for Commission counsel to

represent Mr. Nicolaisen, to prepare him for potential testimony about views he expressed and events that happened several years ago before he left the public sector, and to protect the Commission's privileges. Moreover, it is entirely possible that, in representing Mr. Nicolaisen, Commission counsel would have to draw upon other Commission resources, including current staff in the Office of the Chief Accountant. Further, if Mr. Nicolaisen were to testify, that could lead to additional requests in the private litigation by plaintiffs or other parties for other Commission personnel, both current and former, to testify about the accounting issues and meetings referenced by lead plaintiffs.

In assessing burden, as with lead plaintiffs' public interest argument, we recognize the importance of Commission employees performing their statutorily mandated duties rather than participating in private litigation. As the Court of Appeals stated in Watts, "discovery under F. R. Civ. P. 26 and 45 must properly accommodate 'the government's serious and legitimate concern that its employee resources not be commandeered into service by private litigants to the detriment of the smooth functioning of government operations.'" 482 F.3d at 509-10 (quoting *Exxon Shipping Co. v. Dep't of Interior*, 34 F.3d 774, at 779 (9th Cir. 1994)); *see also Davis Enterprises v. EPA*, 877 F.2d 1181, 1187 (3d Cir. 1989) (agency had "legitimate concern with the potential cumulative effect" and "proliferation of testimony by its employees" that compliance with individual subpoena would entail). We conclude that the burden on the Commission here likely would be significant.

Lead plaintiffs' final argument is that Mr. Nicolaisen's testimony would not be protected by the Commission's privileges. However, we share the concern expressed by the AGC that much of any testimony Mr. Nicolaisen might offer would be protected by the Commission's privileges, in particular the deliberative process privilege: "Testimony regarding the bases for Mr. Nicolaisen's conclusions as to Fannie Mae's accounting practices and policies with respect to SFAS 91 and 133, the scope and nature of the documents he reviewed and relied upon in reaching his conclusions, and any communications he had with other federal government regulators before he issued his December 15, 2004 statement would be protected because his testimony would reflect the deliberations that led to his statement." See DOI v. Klamath Water Users Protective Ass'n, 532 U.S. 1, 8 (2001); NLRB v. Sears Roebuck & Co., 421 U.S. 132 (1975); Mead Data Central v. United States, 566 F.2d 242 (D.C. Cir. 1977).

More specifically, internal staff deliberations within the Office of the Chief Accountant or discussions with other Commission divisions or offices would be protected if they influenced Mr. Nicolaisen's views, as would be any testimony he might provide about any documents upon which he relied. See Montrose Chemical v. Train, 491 F.2d 63, 71 (D.C. Cir. 1974); *see also Schele v. DHS*, 843 F.2d 933, 942 (6th Cir. 1988) ("It is the free flow of advice, rather than the value of any particular piece of information" that the privilege protects). The same would be true for any non-public meetings and conversations with, or documents shared by, representatives of OFHEO or other federal agencies if he relied upon them in formulating his conclusions. Testimony by Mr. Nicolaisen even about non-privileged documents may reflect his judgment process of

sifting through a series of documents to identify those that are the most relevant, and that may be part of the deliberative process. See California Native Plant Society v. EPA, 251 F.R.D. 408, 412 (N.D.Cal. 2008)(deliberative process privilege “protects the decision making process at large, and a document need not lead to a specific decision, let alone a final decision, in order to be protected”).

Although we recognize that the deliberative process privilege can be overcome by a showing of particularized need, lead plaintiffs have not made such a showing. Instead, they conclusorily state that Mr. Nicolaisen’s personal views are “highly relevant” to defendants’ scienter, declare that he “possesses information unavailable elsewhere” (which, as noted above, seems unlikely), and reemphasize the scope and significance of their case. We do not believe that suffices as a showing to overcome the Commission’s strong interest in protecting its deliberative process from discovery, especially when considered against what we fear would be the substantial chilling effect upon future Commission deliberations if the internal decision-making process of the Commission and its staff is not protected. See Casad v. Dep’t. of HHS, 301 F.3d 1247, 1251 (10th Cir. 2002)(underpinning the privilege is “the obvious realization that officials will not communicate candidly among themselves if each remark is a potential item of discovery and front page news, and its object is to enhance the quality of agency decisions by protecting open and frank discussion among those who make them within the government”); Hunton & Williams, LLP v. Dep’t of Justice, 2008 WL 906783, *8 (E.D.Va. 2008)(deliberative process privilege is intended to insulate government employees from the likely chilling effect if internal agency deliberations are made public).

CONCLUSION

For the reasons stated above, and in accordance with Rules 411(b)(2) and 431(b)(2) of the Rules of Practice, the Petition for Review is denied.

By the Commission.

Elizabeth M. Murphy
Secretary