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Thursday, April 1, 2004

TECH THURSDAY

The Business of Technology

.com

Leslie Walker

The Promise Of a Broader Superhighway

If Al Gore invented the information superhighway, then President Bush ought to be able to raise the speed limit.

Or so Bush seemed to be saying on Friday when he called for extending high-speed Internet to every U.S. home within three years.

"This country needs a national goal for broadband technology, for the spread of broadband technology," Bush said while campaigning in Albuquerque. "We ought to have a universal, affordable access for broadband technology by the year 2007, and then we ought to make sure as soon as possible thereafter, consumers have got plenty of choices when it comes to purchasing the broadband carrier."

Bush offered no details of how to achieve his goal beyond saying Congress should refrain from taxing broadband access and, in another speech on Tuesday, adding that we need "the right regulatory environment."

For starters, Bush could come up with a fresh definition of "broadband," one of those awful buzzwords whose meaning grows fuzzier with each new technology it's used to describe. Broadband is slang for any form of Internet access faster than dial-up. How much faster depends on who's selling it, and there are lots of competing flavors.

In reality, though, most flavors available to consumers in the United Sates today are still middleband—the equivalent of barreling down a highway in a car, while real high-speed Internet access is more like air travel. Increasingly, real broadband is available in South Korea, Hong Kong and other parts of Asia, where governments have helped defray the considerable cost of laying fiber-optic lines to many homes.

But it remains tantalizingly elusive in the United States, where the market

See **.COM**, *E6, Col. 1*

OPEC Votes to Trim Output

Oil Producers Will Cut 2.5 Million Barrels Daily

By John Burgess
Washington Post Foreign Service

BERLIN, March 31—OPEC oil ministers agreed Wednesday to proceed with a 4 percent cut in oil production beginning Thursday, turning aside criticism from industrial countries that any resulting price rise will harm the world economy.

With oil prices emerging as an election-year issue, the White House called the move disappointing and said that administration officials were "actively engaged" on the issue with the governments of the Organization of Petroleum Exporting Countries.

Oil ministers from the cartel's 11 member states, meeting in Vienna, upheld a February decision to cut production by 2.5 million barrels a day on grounds of avoiding a price-deflating buildup of oil supplies in world markets. But some oil industry analysts said any price rises could be blunted by drops in demand as warmer weather arrives and by continued cheating on official quotas as member countries try to maximize their incomes while prices remain near 13-year highs.

See **OPEC**, *E4, Col. 1*

BY OSCAR KORNYEI—BLOOMBERG NEWS

Purnomo Yusgiantoro, Indonesia's oil minister and OPEC's president, explains the cartel's justification for reducing production to 23.5 million barrels a day as U.S. gasoline prices soar.

Consumers Seek Low-Price Pumps

By Bill Brubaker *and* Anitha Reddy
Washington Post Staff Writers

Freddy Haro was feeling the pinch of higher gas prices yesterday as he pumped super premium into his baby blue 1979 Ford Granada.

A sign over the pump at Van Ness Auto Care on Connecticut Avenue NW read, "Lowest Price." But Haro, 55, a J.C. Penney salesman and part-time restaurant worker, wasn't impressed.

"Not long ago, it took $15 to fill up this car," he said as the fuel, priced at $1.88 a gallon, flowed through the hose. "Now it's costing me $15 for half a tank."

The average dollar amount paid for a gallon of unleaded regular gas in Virginia and Maryland hit records yesterday in a survey by AAA. But motorists still haven't dramatically altered their driving habits or decided to dump their sport-utility vehicles for scooters. As gas prices edge higher, consumers are paying close attention to roadside prices and often pulling in where prices are lowest.

The Organization of Petroleum Exporting Countries added upward pressure yesterday by agreeing to cut oil

See **GAS**, *E4, Col. 4*

U.S. Deal To Lease Tankers Criticized

Report: Procedures Waived for Boeing

By R. Jeffrey Smith
Washington Post Staff Writer

The Air Force negotiated a contract to lease refueling aircraft from Boeing Co. that could cost hundreds of millions to several billions of dollars more than it should, and followed a procurement strategy that demonstrated poor stewardship of Defense Department funds, according to a long-awaited report by the department's inspector general.

The $23.5 billion program—the costliest lease in U.S. history—is currently suspended, pending a series of Defense Department reviews and the outcome of a criminal investigation in Virginia into potential wrongdoing. But the report, which was presented yesterday to members of the U.S. Senate, indicates the deal is unlikely to proceed on anything like the original contract terms.

It states that senior Air Force officials failed to comply with military contracting laws, wrongly exempted Boeing from disclosing vital price information, accepted insufficient or inaccurate Boeing data during its negotiations, and wrongly waived any right to audit the program once it gets started.

It also states that the Air Force—despite

See **BOEING**, *E4, Col. 1*

BY TED S. WARREN—ASSOCIATED PRESS

Rep. Norman D. Dicks (D-Wash.), praising the first Boeing 767 Tanker Transport last July, is an advocate of the leasing deal.

DIGITAL CAPITAL

Ellen McCarthy

Tech Security Arrives as the New Big Thing

Steven I. Cooper, the **Department of Homeland Security**'s chief information officer, had just wrapped up a speech at the government technology trade show FOSE last week when they began lining up: a dozen or so eager information security company executives making on-the-fly sales pitches.

To many of the executives, Cooper and the billions of contracting dollars he represents are the ultimate pot of gold.

Cooper joked that a hundred people have told him they can solve all of the nation's cyber-security problems. Some of the department's staff members are looking at hundreds of proposals a week and while the evaluation process is not perfect, he said, "we're trying to listen and trying to talk to as many companies as we can."

As the dangers to data and communications have escalated in number and severity over the past few years, providers of encryption technology, information assurance, firewalls and other security companies have proliferated.

In the Washington area, at least 13 security firms were added this year to the Greater Washington Initiative's just-published directory of network security firms. The number of local employees working at listed companies grew by 5 percent, to 4,064.

Last week, FOSE was overrun with security companies offering seminars and product demonstrations. More than a fifth of the 500 exhibitors at FOSE, which is owned by a division of The Washington Post Co., identified themselves as security providers.

Standing out can be a problem.

"It is a real marketing challenge," said **Wayne Jackson**, chief executive of **Sourcefire Inc.**, a Columbia network security company. "There are a lot of smart people saying similar-sounding things. It lengthens sales cycles and obliges us to

See **DIGITAL**, *E6, Col. 3*

Martha Stewart's lawyers allege that juror Chappell Hartridge, right, lied about his past in order to get on her trial panel.

Stewart Seeks Retrial Over Juror's Past

By Brooke A. Masters *and* Ben White
Washington Post Staff Writers

NEW YORK, March 31—Martha Stewart asked to have her felony convictions overturned and a new trial ordered, arguing that the most outspoken member of the jury that convicted her had concealed previous brushes with the court system, including an arrest on domestic assault charges.

Stewart's lawyers wrote in a motion filed Wednesday that Chappell Hartridge lied in his sworn court questionnaire, failing to disclose that he had been briefly jailed for assaulting a former girlfriend and had been sued at least three times. The lawyers also alleged that former youth baseball league officials said that Hartridge embezzled money from the Kingsbridge Little League in the Bronx.

After Stewart's March 5 conviction on charges of conspiracy, obstruction and lying about a personal stock sale, Hartridge, 47, became the public face of the jury, appearing on camera and speaking freely to the media about the verdict. He said then that he viewed the conviction as "victory for the little guy" who takes the losses in the stock market while well-connected insiders profit at his expense.

"Hartridge is a man with a checkered history, who deliberately concealed his pri-

See **STEWART**, *E6, Col. 1*

Proposal on Stock Options Issued

Opponents Say Rule Would Harm Start-Ups, High-Tech Firms

By Jackie Spinner
Washington Post Staff Writer

The private board that sets U.S. accounting policy yesterday issued its long-debated draft rule to require companies to start treating stock options as expenses next year, setting the stage for a showdown with Congress and the high-tech industry, which opposes the idea.

A report Bear, Stearns & Co. issued yesterday shows why technology companies don't like the Financial Accounting Standards Board (FASB) proposal. The report calculated that net income in 2003 for the companies on the tech-heavy Nasdaq 100 index would have dropped about 44 percent if the firms had been required to treat options as expenses. Net income the same year for companies in the Standard & Poor's 500-stock index would have dropped only about 8 percent.

"How many elected officials will want to see the Nasdaq 100 take a 44 percent hit" in an election year, said Jeffrey Peck, a key lobbyist pushing legislation that would block the rule. "Undoubtedly, not many."

Opponents say the rule would eliminate a powerful recruiting tool for small businesses and start-ups that rely on options for compensation when they don't have a lot of cash.

Options give an employee the right to

See **OPTIONS**, *E4, Col. 5*

Agency Hints at Fannie Restatement

By David S. Hilzenrath *and* Kathleen Day
Washington Post Staff Writers

Fannie Mae, the nation's largest funder of home loans, might have to correct published financial statements as a result of an ongoing government review of its accounting, the company's regulator said yesterday.

"The outcome of the review may result in a restatement of prior period results," the Office of Federal Housing Enterprise Oversight said in a news release that focused mainly on a routine review of the capital requirements of Fannie Mae and its financial cousin and competitor, Freddie Mac.

The agency is discussing with Fannie Mae whether the company correctly accounted for and valued key assets, according to a source who spoke only on the condition of anonymity. The amount of money at issue could not be determined.

Fannie Mae spokesman Charles V. Greener said that the review started only recently and will examine all aspects of the company's finances and that the OFHEO has reached no conclusion. He said the company has just filed its "fully audited" annual report

BY SUSAN WALSH—ASSOCIATED PRESS

Sen. Richard C. Shelby's bill would set up a new oversight agency to regulate Fannie Mae and Freddie Mac.

with the Securities and Exchange Commission. "We are not aware of anything that backs the assertion that there may be a need for us to restate our financial

See **FANNIE**, *E4, Col. 1*

INSIDE

DOW 10,357.70 DOWN 24.00, 0.2% | **NASDAQ 1994.22** DOWN 6.41, 0.3% | **STANDARD & POOR'S 500** 1126.21, DOWN 0.79, 0.1% | **WASH. POST-BLOOMBERG** REGIONAL 228.12, UP 0.93, 0.4% | **10-YEAR TREASURY NOTE** UP $4.69 PER $1,000, 3.83% YIELD | **CURRENCIES** 104.35 YEN=$1, EURO=$1.2305

Report Criticizes Leasing Deal With Boeing

BOEING, *From E1*

past pledges—cannot "ensure to the warfighter" that the tankers will meet the military's operational requirements. Specifically, the planes "may not be . . . effective, suitable, and survivable" in battle.

The tanker lease had aroused controversy inside and outside the Bush administration for the past two years. The Pentagon's leadership agreed to back the project last year despite objections from a few members of Congress and initially the Office of Management and Budget, after President Bush personally asked his aides to work out a deal, according to a senior administration official and internal Boeing communications unearthed in a congressional investigation.

Bush's chief of staff Andrew H. Card Jr. became directly involved in the contract negotiations following an aggressive lobbying campaign by Boeing, a major donor to Bush's inauguration and to key members of the House and Senate armed services committees. House Speaker J. Dennis Hastert (R-Ill.) and Rep. Norman D. Dicks (D-Wash.), whose districts are in states with Boeing facilities, are major advocates of the leasing deal.

A grand jury in Virginia is nearing the end of its investigation into potentially illegal actions by Darleen Druyun, a top Air Force official involved in the contract talks, according to officials who spoke on condition they not be named. Druyun was hired by Boeing while the contract talks were underway, and then fired after an internal review found improprieties in her hiring.

Boeing also fired its chief financial officer over what it depicted as an attempted coverup of the hiring procedures. The Pentagon subsequently decided to suspend the contract pending completion of the inspector general's report and separate studies by the Defense Science Board and National Defense University of the plane's price and capabilities.

Boeing spokesman Douglas Kennett said he could not comment in detail until the report is officially released. But he said the tanker meets all Air Force requirements and is better than any competition. Air Force spokeswoman Alvina Mitchell said "we are heartened by the fact that the IG's number one observation was that there was no compelling reason not to proceed. Before we proceed, we will ensure that it is a good deal for the U.S. taxpayer, that it has been thoroughly reviewed by DOD [the Department of Defense] with oversight by Congress."

Air Force Assistant Secretary Marvin Sambur, who oversaw the contract negotiations, is recorded in the report as dissenting from most of its conclusions. But Inspector General Joseph E. Schmitz said in the report that he stuck by its conclusions, despite Sambur's complaints. "The Air Force used an inappropriate procurement strategy and did not demonstrate best business practices or prudent acquisition procedures" in its contract talks, the report states.

"The strategy places the Department at high risk of paying excessive prices and profits and precludes good fiduciary responsibility for DOD funds," it states.

Senior Air Force officers relied in part on "questionable," inappropriate or unreliable pricing and cost data from Boeing Web pages and brochures related to other aircraft, the report states. They also failed to comply with laws that require testing of such major weapons systems. The deal does not, moreover, meet three of six regulatory criteria for leasing instead of buying aircraft. The report said leasing instead of buying may cost the Pentagon "at least $560 million more."

Separately, the report states that the price of the 100 aircraft could be "overstated from $530 million to $2.4 billion," without making clear if this estimate includes the other estimate of the overspending.

Schmitz said that while he found no "compelling reason" during his own review not to proceed with the tanker program, he recommended that the Pentagon decide "whether leasing rather than purchasing" the aircraft provides "the best value," and said that in any event, the contract terms should be altered.

OPEC Sees Need to Cut Production

OPEC, *From E1*

Following news of the decision, White House spokesman Scott McClellan said that "producers should not take steps that harm American consumers and our economy." President Bush has not called OPEC leaders about the issue, McClellan said, but officials in his administration are in touch.

As gasoline prices have risen, John Kerry, the presumptive Democratic nominee for president, has increasingly been citing oil in his campaign appearances. On Tuesday, he said that Bush had "done nothing with OPEC to reduce the gas prices." Bush criticized Democrats as planning higher gas taxes.

Meeting in Algiers in February, OPEC ministers made a decision to reduce daily quotas by 1 million barrels, to 23.5 million barrels a day, starting April 1 and to immediately crack down on additional 1.5 million barrels of daily production in excess of quotas. At the time, prices were hovering around $28 a barrel, and ministers said a cut was necessary to keep prices stable as demand dropped at the end of the heating season.

Rather than stabilizing, prices have risen steadily in the seven weeks since that decision, partly because of the OPEC announcement, analysts said, and partly because of pressure from speculators. Earlier in March, oil briefly sold for more than $38 a barrel, the highest level since the 1991 Persian Gulf War, before falling back to the current level of about $36.

As this week's meeting approached, some industry analysts predicted that with such a rise, the cartel might opt to forgo production cuts. According to reports from Vienna, a number of OPEC members raised this issue in unofficial meetings on Wednesday before the formal sessions. But Saudi oil minister Ali Ibrahim Naimi, whose country is traditionally OPEC's most influential, trumped those concerns with an endorsement of going ahead.

"I think there is enough supply in the market," said Kuwaiti oil minister Sheikh Ahmad Fahd Ahmad Sabah, Bloomberg News Service reported.

The question in the oil markets now is how seriously the cartel will enforce the cuts. The cartel is historically undisciplined. Year after year, members have pledged to each other to produce only a set volume in order to keep world prices at certain levels, but privately they sell more to gain a windfall.

Oil prices fell by about $1 a barrel in the hours after Wednesday's announcement, as traders interpreted the details to mean that much of the cut would be illusory. "There isn't much credibility," said Marshall Steeves, an energy analyst at Refco Group, a New York-based financial services firm. "Overproduction or cheating—call it what you want—has been quite rampant in the last few months."

In recent months, cartel members have "been put in a position where they produce at near capacity levels, thereby maximizing revenues, without cutting production," Steeves said. "It's been an ideal situation for them. They'll try to continue that for as long as they can."

He predicted a reduction of only 200,000 or 300,000 barrels a day. With more oil flowing out of Russia and Iraq, he said, world markets would remain well supplied. OPEC accounts for nearly 40 percent of global oil production.

Ed Silliere, vice president of risk management at Energy Merchant Corp., a petroleum products distribution company based in New York, saw somewhat more impact. "It's quite possible they could cut a million barrels a day—I have no doubt about that. But what about the extra million and a half that they're cheating on? We have no evidence that they've reined in excess production," he said.

Also helping bring prices down was release of the U.S. Energy Information Administration's latest weekly report showing that domestic crude oil inventories finished last week at about 294 million barrels, their highest level since August 2002.

On Tuesday, Kerry said that as president he would pressure OPEC about production levels and would stop buying oil for the U.S. Strategic Petroleum Reserve until prices fell. Kerry contends that by decreasing overall demand, this could have the effect of lowering prices.

McClellan told reporters on Wednesday that Democrats had blocked passage of Bush's energy plan. Without the plan's increase in drilling and energy conservation, he said, "we continue to go from crisis to crisis." The White House contends that stopping purchases for the reserve would have negligible impact on prices and that it is important to keep filling the reserve.

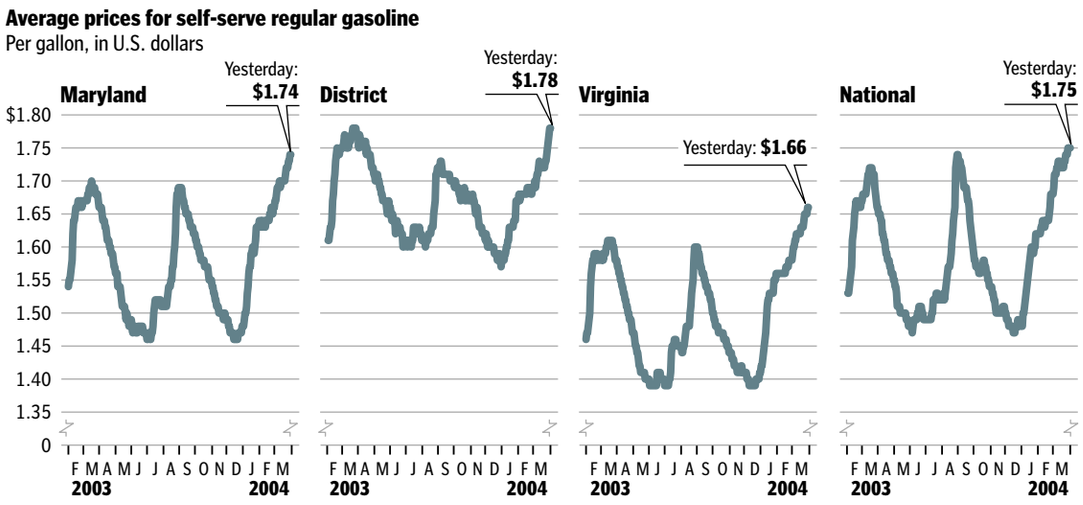
BY MICHAEL WILLIAMSON—THE WASHINGTON POST

In Kensington, self-serve regular unleaded gas at an Amoco station sells for $1.91, among the higher prices in the Maryland suburbs.

Fueling Reaction

High gas prices are becoming a political as well as pocketbook issue.

Average prices for self-serve regular gasoline
Per gallon, in U.S. dollars



SOURCE: AAA Mid-Atlantic

THE WASHINGTON POST

Drivers Factor In Prices

GAS, *From E1*

production by 4 percent. When asked where prices are heading from here, Deborah DeYoung, a spokeswoman for AAA Mid-Atlantic, said, "Up."

Nationwide, the price of a gallon of regular gas averaged $1.75 yesterday, according to AAA. High as prices seem, when adjusted for inflation they are below the peak levels of the early 1980s. To match 1981 prices, a gallon of gas today would have to top $2.80.

In Maryland, the average price yesterday rose to $1.74, and in Virginia it climbed to $1.66. The average price in the District was $1.78.

And so the search intensifies for a pump that saves pennies. Chris Recio, 30, said he drives to Woodbridge to buy gas even though he lives in Arlington. "It's at least 25 cents cheaper," he said yesterday as he filled up the tank of his 1996 Chevy Blazer at an Exxon station in Woodbridge.

The savings add up, Recio said. He said he drives 250 miles round-trip to visit his girlfriend, a student at James Madison University in Harrisonburg, Va., about three weekends a month.

Marie Seabrooks lives in Fairfax Station, but she also drives to Woodbridge to buy gas. "It's about 9 cents a gallon cheaper," said Seabrooks, a retired teacher.

Yesterday, she was loading up on relatively cheap gas ($1.65 for regular) before driving to Charleston, W.Va., tomorrow to visit her daughter. "This is one penny cheaper" than a station down the street, she said. "It all adds up."

Drew Domescik, a Johns Hopkins University graduate student, said he drove straight past a gas station in upper Northwest that wanted $1.97 a gallon for premium. Instead, he filled up his Chevy Tahoe for $1.88 a gallon at Van Ness Auto Care.

"Obviously, these prices are all inflated," he said. "But there is not much you can do about it. I guess we may have to find some alternative sources of energy."

For taxi driver Abraham Woldemichael, finding cheaper prices is crucial, even if it means some hardship. "I found a station near my home in Silver Spring where the prices are 5 cents, 8 cents a gallon cheaper," said Woldemichael, 37, as he drove past a Citgo station at the intersection of River Road and Little Falls Parkway in Bethesda, where unleaded regular was priced at $1.82. "The lines are usually long. It takes me 10 minutes to get out of there. But it's worth it."

Some drivers still prefer convenience over price. "I just got my car inspected at this station, so now I'm filling up," said Cindy Arkin, 35, at a Shell station on River Road that charged $2.04 for premium and $1.84 for unleaded regular. "I don't pay attention to the price."

The sight of the gas pump ringing up bigger and bigger amounts is just too much to bear for some drivers. Linwood White, a manager at a fundraising firm for nonprofit organizations, said he no longer fills up the tank of his 1999 Ford Expedition at $40 a pop. He can only stand pumping a few gallons at a time.

"Congress should be doing something about gas prices," he said.

Fuel efficiency is starting to look attractive to some commuters. Jason Raysor, a 21-year-old massage therapy student, spends at least an hour commuting from Gaithersburg to his school in Falls Church in his '93 Ford Escort.

He said he didn't consider gas mileage when he bought the Escort, but lately he's thinking about making his next car a hybrid. "People say they don't have as much power," he said, but he couldn't help noticing one leave him in the dust a few days ago. "I was going 70, and they were flying past me."

For Domescik, the Johns Hopkins student, it will take a much steeper rise in prices before he ever considers trading in his Chevy Tahoe.

"I need a big car," he said. "I have a dog."

Senate Considers Fannie, Freddie Regulation

FANNIE, *From E1*

results," he said. "If anyone has evidence to the contrary, they should share it with us directly. Otherwise, it is irresponsible to speculate on this topic and affect markets where billions of dollars of securities are traded every day. The Post should not use anonymous sources for such an irresponsible allegation."

The disclosure came as the Senate Banking Committee prepared to renew efforts today to create a stronger regulator for Fannie and Freddie. There were signs that lobbying by the companies was affecting the debate on the proposal of committee Chairman Richard C. Shelby (R-Ala.).

Fannie Mae, for example, ran television and radio ads locally that warned of potentially dire consequences. Reminiscent of the "Harry and Louise" campaign that helped doom President Bill Clinton's effort to overhaul health care, the ads depict a man and a woman in their kitchen fretting that interest rates could go up if the bill passes and "that could mean we won't be able to afford the new house." An announcer says that "taking the wrong path could close the door of home ownership to millions of families."

Shelby's bill would create a new regulatory agency to replace the OFHEO and give it the power to put Fannie and Freddie in receivership if they became insolvent or experienced other serious troubles. That would address the concern of some government officials, including Federal Reserve Chairman Alan Greenspan, that the federally chartered companies pose a risk to the government and the financial system.

At least symbolically, the Shelby bill challenges the widespread perception that the government would bail out Fannie or Freddie in a crisis, a perception that has helped the companies borrow money at favored rates. Giving the regulator receivership powers is "crucial" and "a core component of any credible legislative effort," Treasury Secretary John W. Snow said this week in a letter to Shelby.

Sen. Paul S. Sarbanes (D-Md.), the ranking Democrat on the committee, proposed a substitute for Shelby's bill that does not include the power to put the companies in receivership. Fannie Mae was Sarbanes's largest contributor over the past several years, with contributions of $23,500, according to Opensecrets.org, the Web site of the Center for Responsive Politics.

A senior Republican on the committee, Robert F. Bennett (Utah), proposed an amendment to Shelby's bill that would leave the power to authorize a receiver with Congress. Fannie Mae was Bennett's second-largest contributor with donations of $23,500, according to Opensecrets.org.

Bennett's concern "is that if we get a rogue regulator, the bill as it stands provides no opportunity for checks on that regulator," said Mary Jane Collipriest, Bennett's spokeswoman. She said his idea has bipartisan support in the committee.

Though their roles may be hazy to the public, Fannie and Freddie are powerful behind-the-scenes players in the nation's mortgage-financing system. The government-sponsored enterprises borrow money from investors and buy mortgages from retail lending institutions. They repackage pools of mortgages into securities for which they guarantee streams of payments.

The legislation may be Congress's last run at the issue before the November elections, and recent history shows how difficult it could be to pass a bill. Last year, the House Financial Services Committee abandoned a similar effort without even proceeding to a markup.

The impetus for the regulatory effort was an accounting scandal last year at Freddie Mac, which had engineered elaborate transactions to smooth earnings unbeknownst to the OFHEO. A $1 billion accounting error at Fannie Mae in the fall gave the movement an added kick.

The companies have weathered similar political challenges year after year without any major change in their status. In an October 2000 speech, after a series of congressional hearings, Fannie Mae chief executive Franklin D. Raines explained why the company had been confident of the outcome.

"We make a tangible difference in their [lawmakers'] districts, for their constituents," Raines said. "And if you damage Fannie Mae's ability to fulfill its mission, you will drive up mortgage costs, you will harm the housing industry and you will drive millions of families out of the home-buying market. And nobody really wants to take credit for that."

Meanwhile, Freddie Mac held an uneventful annual stockholders meeting yesterday, its first since the accounting turmoil led to the ouster of two chief executives their jobs, a $125 million fine, and continuing investigations.

New chief executive Richard F. Syron expected yesterday's annual meeting to take hours, with angry investors venting about the company's ongoing accounting scandal. Instead the meeting lasted just over an hour and included few hostile questions from the several hundred shareholders in a McLean Hilton ballroom for their first chance to question Syron face-to-face since he joined the company three months ago.

"Credibility is an issue for us," Syron told the audience as he promised the company will strive to meet its self-imposed deadline of June 30 for issuing 2003 financial statements, which the accounting problems have delayed.

Yesterday's meeting was a year late. It was supposed to be held 12 months ago, after the release of the McLean-based company's 2002 financial statements. But those results weren't released until November, after the company corrected its statements by $5 billion.

That correction in turn delayed the company's release of its 2003 financial statements. Syron said it's possible that some as-yet-unforeseen problem will delay that release past June 30, but he said returning the company to timely financial reporting is his first priority.

Once the 2003 figures are issued, the company expects to hold its 2004 annual meeting two or three months later.

Rule Would Treat Options As Expense

OPTIONS, *From E1*

buy stock at a set price, so if the stock price rises, the employee can sell at a profit, in theory, giving the employee an incentive to help the company succeed. They are the only form of compensation that companies do not have to deduct from their bottom lines.

"It is not a level playing field," said G. Michael Crooch, a member of the FASB. "They are compensation. They ought to be expensed as compensation." He said the rule, which gives companies several choices of how to value options, is not intended to "harm or help" any individual company.

"We believe our job is to provide high-quality, neutral financial information so people who make decisions based on financial statements have neutral information."

Rep. Richard H. Baker (R-La.), chairman of a House Financial Services subcommittee that will hold a hearing on the proposed rule April 21, issued a statement yesterday saying, "I fear FASB is beginning to stand for Flatten All Start-up Businesses."

Some financial analysts don't agree that the rule would have a significant impact on companies or investors.

Pat McConnell, senior managing director at Bear Stearns, said the marketplace already accounts for the cost of stock options, even if companies don't. Since 1995, companies have had to show, in footnotes to their financial statements, how counting options as expenses would have affected their profit.

"As an expense, the impact on value over a long period of time will be very minimal," she said.

In a separate study released yesterday, financial consulting firm Towers Perrin found no impact on the share price for more than 300 companies that have voluntarily started to expense options.

Richard N. Ericson, a principal of Towers Perrin, said requiring companies to treat options as expenses will force them to look at other forms of incentives, such as restricted stock, that might be better, for both companies and employees.

"Once you are less excited about stock options because they are no longer free, that's good," he said. "You are free to make choices."

Among the companies that started counting options as expenses last year was Philadelphia-based Technitrol Inc., which manufactures electronic components. Its options reduced the company's 2003 net income by $2.1 million, to $12 million. "We consider all forms of compensation to be a cost of doing business," said spokesman David J. Stakun.

DAILY 09-23-04 MD M2 A1 CMYK

Weather

Today: *Mostly sunny. High 84. Low 66.*
Friday: *Patchy fog early, warm. High 82. Low 64.*

Details, Page **B8**

The Washington Post

127TH YEAR NO. 293 M2 DC MD VA

THURSDAY, SEPTEMBER 23, 2004

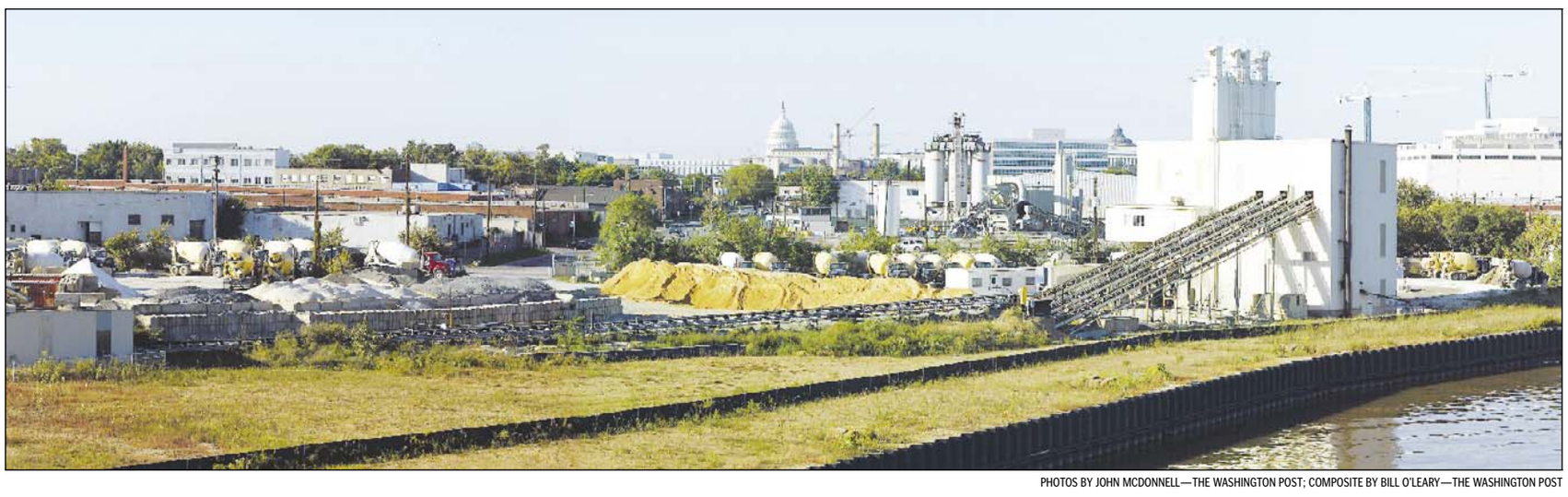
M1 M2 M3 M4 V1 V2 V3 V4

FINAL

Inside: **Home, local news Extra**
Today's Contents on Page A2

35¢

Prices may vary in areas outside metropolitan Washington. (See box on Page A2)



PHOTOS BY JOHN MCDONNELL—THE WASHINGTON POST; COMPOSITE BY BILL O'LEARY—THE WASHINGTON POST

A panorama—made up of four photos—looks north toward the Capitol from the Anacostia waterfront and shows the 20-acre site proposed for the baseball stadium. The location is in a mostly industrial area of Southeast Washington . "It's a blight over there. This may be an opportunity for economic development in that area," neighbor Mary C. Williams said.

D.C. Selling Stadium Deal to Business Leaders

Baseball Panel Meets Today to Consider Moving Expos in Spring

By LORI MONTGOMERY *and* SERGE F. KOVALESKI
Washington Post Staff Writers

District officials yesterday began selling their plan to build a waterfront ballpark to business leaders who would end up paying the bulk of the cost, as a panel of Major League Baseball owners prepared for a meeting that could spur the return of the national pastime to the nation's capital.

The stadium, which would be located on the shores of the Anacostia River less than a mile south of the U.S. Capitol, is expected to cost more than $400 million. About $65 million would be set aside to acquire the 20-acre site. The collection of vacant lots, industrial sites, brick rowhouses and clubs is controlled by 27 private owners.

The sales pitch to business leaders, which will continue today, was another sign that negotiations to bring baseball to Washington had entered a new, if still uncertain, stage.

Baltimore Orioles owner Peter G. Angelos, who is expected to attend today's meeting in Milwaukee, remains adamantly opposed to moving the Montreal Expos to Washington, a baseball official said yesterday. The official, who spoke on condition of anonymity, said informal discussions about compensation for Angelos have gone nowhere.

In Washington, City Administrator Robert C. Bobb said the District will try to negotiate with owners of the land on which the stadium would be constructed but would use

See **BASEBALL**, *A15, Col. 4*

■ **Team would get a typical deal.** | *Page B1*

■ **Orioles owner has not yet agreed.** | *Page D1*

BY ANDREA BRUCE WOODALL—THE WASHINGTON POST

An Unwelcome Prospect

Patricia Ghiglino, who runs a sculpture studio near a proposed site for a baseball stadium, is among Southeast residents not eager to have a ballpark.

METRO

Report Slams Fannie Mae

U.S. Regulators Find Accounting Failures At Housing Financier

By DAVID S. HILZENRATH
Washington Post Staff Writer

Fannie Mae, the giant mortgage finance company, has used improper accounting methods that raise serious questions about the quality of its management and the validity of its financial reports, government regulators reported yesterday.

Though it didn't quantify the effect of what it called pervasive misapplication of accounting rules on the company's books, the report by the Office of Federal Housing Enterprise Oversight cited one instance in 1998 where the company inappropriately deferred $200 million of estimated expenses, which enabled management to receive full annual bonuses. Had Fannie recorded the expenses in 1998, no bonus would have been paid, the report said.

The report also detailed numerous transactions over several years where it said Fannie Mae management intentionally smoothed out gyrations in its earnings to show investors it was a low-risk company. Fannie "maintained a corporate culture that emphasized stable earnings at the expense of accurate financial disclosures," regulators said in a letter to the company.

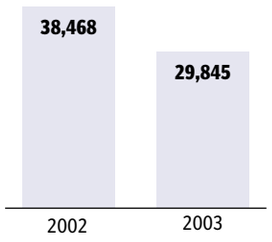
Chief executive Franklin D. Raines and the board of directors were not singled out for blame, but the report criticized "a culture and environment that made these

See **FANNIE**, *A17, Col. 1*

■ **CFO's role criticized; warnings grew along with firm.** | *Page E1*

Dropping Off

The number of green cards issued in the Washington area fell by 22.4 percent in 2003.



SOURCE: U.S. Department of Homeland Security

THE WASHINGTON POST

Anti-Terror Measures Delaying Green Cards

By MARY BETH SHERIDAN
Washington Post Staff Writer

The number of foreigners who became permanent U.S. immigrants dropped sharply in 2003 as anti-terrorism measures delayed the processing of applications, according to a new government report.

The report, released recently by the Department of Homeland Security, showed that 705,827 people became legal permanent residents in fiscal 2003, down from 1.06 million the year before. The Washington area recorded a 22 percent decline. A permanent-resident document, known as a "green card," allows an immigrant to live and work indefinitely in the United States and is the first step toward citizenship.

The decline does not mean that immigration is drying up. In fact, the number of newly arrived legal immigrants declined just 7 percent. Most of those affected by the trend were foreigners already here—students, workers and others—who were hoping to become permanent residents. Only 347,416 got green cards in 2003, roughly half the number as in the previous year, because of the slowdown in processing.

Although many of those immigrants were in the United States on temporary visas, the delays in getting permanent papers often caused hardship, immigrant advocates and attorneys said.

"This is really about how the federal immigration system post-9/11 has collapsed," said Michael Mag-

See **IMMIGRANT**, *A15, Col. 1*

Analysis

Despite Bush Flip-Flops, Kerry Gets Label

By JOHN F. HARRIS
Washington Post Staff Writer

One of this year's candidates for president, to hear his opposition tell it, has a long history of policy reversals and rhetorical about-faces—a zigzag trail that proves his willingness to massage positions and even switch sides when politically convenient.

The flip-flopper, Democrats say, is President Bush. Over the past four years, he abandoned positions on issues such as how to regulate air pollution or whether states should be allowed to sanction same-sex marriage. He changed his mind about the merits of creating the Homeland Security Department, and made a major exception to his stance on free trade by agreeing to tariffs on steel. After resisting, the president yielded to pressure in supporting an independent commission to study policy failures preceding the Sept. 11, 2001, attacks. Bush did the same with questions about whether he would allow his national security adviser to testify, or whether he would answer commissioners' questions for only an hour, or for as long they needed.

CAMPAIGN 2004

ASSOCIATED PRESS

John F. Kerry is shown windsurfing in a new Bush ad that says the Democrat's positions shift "whichever way the wind blows."

Democrats working for John F. Kerry cite these twists and turns with glee—but even more frustration. Polls have shown overwhelmingly that Kerry—with his long trail of confusing and sometimes contradictory statements, especially on Iraq—is this year's flip-flopper in the public mind, a criticism that continued to echo across the campaign trail yesterday.

Once such a popular perception becomes

See **ANALYSIS**, *A8, Col. 1*

U.S. to Free Hamdi, Send Him Home

By JERRY MARKON
Washington Post Staff Writer

Yaser Esam Hamdi, who was held in solitary confinement as an "enemy combatant" for nearly three years and never charged with a crime, will be released from custody and flown home to Saudi Arabia, government officials announced yesterday.

Hamdi, a United States citizen, will leave on a military aircraft, probably by the end of the week, said Frank W. Dunham Jr., the federal public defender representing him. The Justice Department said only that Hamdi's release "is currently being arranged."

The U.S. military captured Hamdi with pro-Taliban forces in Afghanistan in 2001. He was sent to Guantanamo Bay along with other detainees until authorities learned that he was born in Louisiana and was a citizen. He has been held in military brigs ever since.

Hamdi's detention came to symbolize the legal clash over the government's anti-terror efforts. The government convinced a federal appeals court in Richmond that the military—and not the courts—had the sole authority to wage war and that courts should defer to battlefield judgments. But in June, the Supreme Court ruled that Hamdi had the right to contest his detention in court.

Now, with his pending release, the mys-

See **HAMDI**, *A14, Col. 3*

■ **Spying charges against detainee dropped.** | *Page A14*

Cueing the Balloons in Hussein's Home Town

Iraqis Hail Tikrit Bridge Repair But Decry Pace of Reconstruction

By JACKIE SPINNER
Washington Post Staff Writer

TIKRIT, Iraq, Sept. 22—The Americans spared few expenses on ceremony Wednesday: Balloons soared over the Tigris River, a U.S. Army band pumped out the Iraqi national anthem, and red, white and black ribbon—representing the colors of the Iraqi flag—stretched across the newly repaired Tikrit Bridge.

Tribal sheiks in traditional robes and municipal officials in dark Western suits lined up to march across the bridge to formally mark the completion of the $5.4 million, U.S.-funded project.

An Iraqi police car began slowly leading the procession toward a group of waiting Americans—troops from the 1st Infantry Division and representatives of the U.S. Agency for International Development (USAID) and its main contractor in Iraq, Bechtel. As the marchers progressed, a soldier hastily took down the red ribbon and stuffed it into his knapsack. An alert Iraqi had pointed out that it might not be the best idea for the governor of Tikrit to be seen cutting a representation of the Iraqi flag with an oversized pair of scissors.

So it went on the day that the Tikrit Bridge reopened, 18 months after U.S. warplanes bombed it in order to cut a crucial

See **BRIDGE**, *A19, Col. 1*

BY CEERWAN AZIZ—REUTERS

Iraqis remove a body from a car at the site of a bombing in western Baghdad. Authorities said 11 National Guard recruits were killed.

A Hostage's Plea

On another violent day in Iraq, a British hostage appealed to Prime Minister Tony Blair to help free women held in Iraqi prisons, as his captors have demanded. Confusion surrounded the status of one imprisoned female scientist. **WORLD**, *Page A19*

INSIDE

Singer Departs

Yusuf Islam, formerly known as the singer Cat Stevens, flew back to London after being detained and denied entry to the United States.

NATION, *Page A14*

FCC Throws a Flag

Commissioners propose fining CBS stations $550,000 for indecency on the Super Bowl halftime show with Janet Jackson.

STYLE, *Page C1*

Goss Confirmed

In a 77 to 17 vote, the Senate confirmed Rep. Porter J. Goss (R-Fla.) to be director of central intelligence.

NATION, *Page A2*

Detroit Seeks Its Own Prize on 'Oprah'

Talk Show Stunt Intended to Lure Back Passenger Car Buyers

By GREG SCHNEIDER
Washington Post Staff Writer

Oprah Winfrey kicked off more than a TV season when she gave away 276 new Pontiac G6 sedans on her show last week. Her headline-grabbing stunt also launched the domestic auto industry on a crusade to reclaim credibility in the American passenger car market.

This fall, the Big Three Detroit automakers are making a high-stakes push to win back car sales from overseas rivals such as Toyota Motor Corp. and Honda Motor Co., which in the past decade have dominated a segment that was once a staple of the domestic industry.

U.S. automakers have neglected the passenger car for years to instead feed the public's appetite for trucks and sport-utility vehicles. The three top-selling cars in the United States are Japanese brands, according to Ward's AutoInfoBank, only a decade after the Ford Taurus reigned as the standard-issue sedan for Americans. Domestic car brands consistently rate lower than the Japanese in consumer quality surveys, and U.S. manufacturers rely on heavy discounts to boost their total sales figures.

Many experts doubt Detroit can quickly turn around a decade of decline and woo skeptical Americans back to domestic sedans. But manufacturers are hoping they can at

See **CARS**, *A16, Col. 1*

Report Calls Fannie Mae Accounting Policymaking 'Dysfunctional'

FANNIE, *From A1*

problems possible." It did name J. Timothy Howard, the company's vice chairman and chief financial officer, saying he "failed to provide adequate oversight" of key control and reporting functions and had jobs in which he both set earnings targets and then the accounting policies that could be used to meet them.

The report said company management didn't adequately investigate allegations of irregularities by a former employee, Roger Barnes, who couldn't be reached for comment last night. It said his concerns were "substantive" and his cooperation with regulators important to their examination.

The findings echo those made last year about Freddie Mac, the other large government-chartered mortgage finance company. Regulators, who launched their Fannie Mae inquiry after the Freddie Mac problems came to light, found that Fannie failed to follow the rules in accounting for complex financial instruments known as derivatives, which the company uses to hedge against movements in interest rates. Much of rival Freddie Mac's accounting problems involved accounting for derivatives.

That probe resulted in a $125 million fine and a management shake-up at Freddie Mac.

The two companies were chartered by the government to provide a steady flow of funds for home mortgages. To do that, they borrow money from investors and buy mortgages from banks and other lenders. They also package mortgages into securities for sale to investors. Together they help finance half the home mortgages in the country.

The report's findings that Fannie lacks sufficient internal controls and that its accounting policymaking is "dysfunctional" added to the regulators' concern about the company's safety and soundness.

Federal Reserve Chairman Alan Greenspan and Treasury Secretary John W. Snow have called for tougher oversight of Fannie and Freddie because they worry that, given the huge scale of their operations, serious financial troubles at the companies could put nation's financial system at risk. Though the government disavows any responsibility for the companies' debts, public and private analysts say the government could be called upon to bail them out in a crunch.

Fannie's stock price fell 6.6 percent yesterday, after the company released a statement summarizing the agency's findings, but before the agency made its 198-page report public. Shares closed at $70.69, down $4.96. The price of the company's mortgage-backed securities weakened slightly.

In response to the OFHEO findings, Fannie announced yesterday that it was setting up a panel of independent directors and hired former senator Warren B. Rudman. "The board takes the report seriously and is working with OFHEO to resolve these matters," Ann McLaughlin Korologos, the presiding director, said in a written statement. She also said the Securities and Exchange Commission has been conducting an informal inquiry "that includes issues raised in the OFHEO report."

Last year, amid the scandal at Freddie Mac, Raines said Fannie had not done anything to circumvent accounting rules. "If we had, I would have violated the law in certifying our financial results," he said.

In a brief statement yesterday, Raines did not address the substance of the regulators' findings. Instead, he pledged that Fannie's management will assist the company's outside directors in responding to the regulators "in any way we can."

"The matters detailed in this report are serious and raise concerns regarding the validity of previously reported financial results, the adequacy of regulatory capital, the quality of management supervision, and the overall safety and soundness of the Enterprise," the regulators' report said. Regulatory capital is a financial cushion the company is required to maintain against potential losses.

The report added fresh fuel to a long-running debate over the way the government regulates Fannie and Freddie. The Bush administration and some members of Congress have been pushing for legislation to tighten regulation of Fannie Mae, but those efforts stalled this year amid policy disagreements and resistance from the companies.

"Investors have been fooled, homebuyers have been cheated, and taxpayers are at risk," said Rep. Richard H. Baker (R-La.), chairman of the House subcommittee on capital markets, calling on Congress to follow through on plans to establish a stronger regulator for Fannie Mae. "Fool us once, shame on you. Fool us twice, shame on us," Baker said.

The agency, which some lawmakers have criticized as ineffective and which has long complained that it was underfunded, had historically vouched for Fannie's safety and soundness. The findings released yesterday were the product of a special review by OFHEO, which in February hired the accounting firm Deloitte & Touche LLP to assist it.

Accounting rules can be subject to different interpretations, and some stock analysts predicted yesterday, in reports to their clients, that the examination at Fannie Mae could turn into a battle of accounting experts. Fannie is audited by KPMG LLP, which declined comment yesterday.

The report said that when Fannie didn't agree with accounting standards-setters, it disregarded their guidance "and accounted for the transactions the way they had originally proposed. This sheds some light on the culture and attitude within Fannie Mae—a determination to do things 'their way.' "

The regulators said the company will need to devote considerable resources to determine the full magnitude of the accounting errors.

In the 1998 incident questioned in the report, Fannie reported paying bonuses to the following executives: chairman and chief executive James A. Johnson, who received $1.932 million; Raines, who then was chairman-designate, received $1.110 million; Chief Operating Officer Lawrence M. Small received $1.108 million; Vice Chairman Jamie Gorelick received $779,625; Howard received $493,750; and Robert J. Levin, who was executive vice president for housing and community development, also received $493,750. The executives either could not be reached or declined comment last night.

In 1999, Raines set a goal of doubling Fannie's earnings in five years. Last year, Fannie met that goal. Employees were rewarded through special stock options pegged to the five-year goal.

Financial performance has also influenced executive compensation in other ways. For example, the size of a bonus pool for Fannie executives in 2002 was based on "an aggressive earnings per share ('EPS') growth measure that Fannie exceeded," the company said in a report filed with the SEC.

Raines received $17.1 million of compensation in 2003, plus stock options the company estimated were worth $3 million when granted.

Staff writers Kathleen Day, Terence O'Hara, David A. Vise and Albert B. Crenshaw and staff researcher Richard Drezen contributed to this article.

DAILY 12-16-04 MD M2 A1 CMYK

Weather

Today: *Mostly sunny. High 47. Low 32.*
Friday: *Partly sunny. High 51. Low 32.*

Details, Page **B10**

The Washington Post

128TH YEAR NO. 11 M2 DC MD VA

THURSDAY, DECEMBER 16, 2004

M1 M2 M3 M4 V1 V2 V3 V4

FINAL

Inside: **Home, local news Extra**
Today's Contents on Page A2

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Prices may vary in areas outside metropolitan Washington. (See box on Page A4)

SEC Tells Fannie Mae To Restate Earnings

Accounting Practices Faulted; $9 Billion Loss Could Result

By DAVID S. HILZENRATH *and* CARRIE JOHNSON
Washington Post Staff Writers

The Securities and Exchange Commission's top accountant last night told mortgage funding giant Fannie Mae that it should correct its past accounting, a directive that could erase 38 percent of the profit the government-sponsored company has claimed since the beginning of 2001.

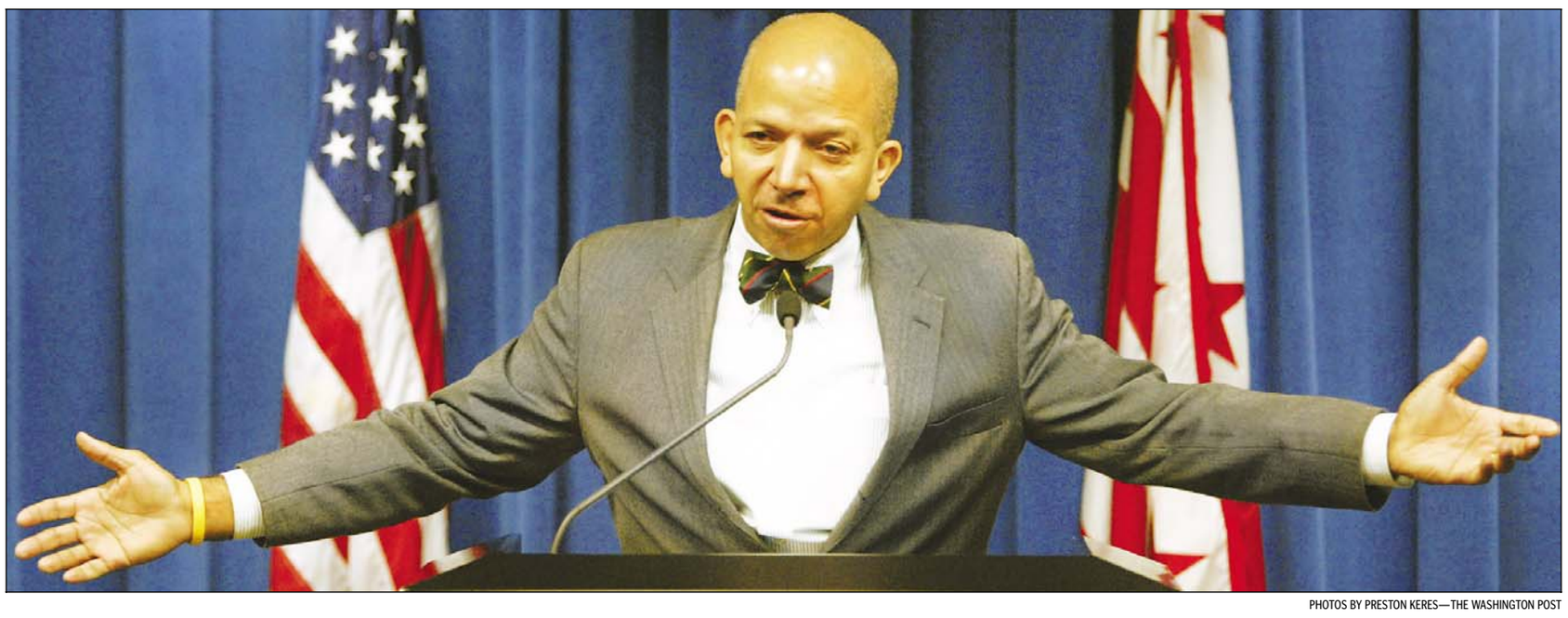
Fannie said last month that if it was required to make such a correction, it might have to record $9 billion of previously unreported losses.

"Fannie Mae's accounting did not comply in material respects" with two major accounting rules, the SEC's chief accountant, Donald T. Nicolaisen, said in a written statement. Instead of following requirements, "Fannie Mae internally developed its own unique methodology," Nicolaisen said.

Nicolaisen's statement was a powerful rebuke to District-based Fannie Mae, which had appealed to the SEC after another agency accused it of manipulating accounting estimates to achieve desired financial results and deliberately violating other accounting requirements to make its earnings smoother.

Fannie Mae spokesman Charles V. Greener said in a statement that the company "will take the steps necessary to comply fully with the SEC's determination." He said the action would leave Fannie Mae with less capital than it is required to hold in reserve against a financial downturn. "The determination made by the SEC will have a negative impact on our minimum capital position, and we

See **FANNIE**, *A13, Col. 1*



PHOTOS BY PRESTON KERES—THE WASHINGTON POST

D.C. Mayor Anthony A. Williams (D) talks baseball at his weekly news briefing, during which he said the deal with Major League Baseball was in "great, great jeopardy."

Baseball Rejects Council's Changes In Financing Plan for D.C. Stadium

D.C. Council Chairman Linda W. Cropp (D) during a news conference. Cropp reiterated that she was not satisfied with a baseball letter intended to allay her concerns.

By DAVID NAKAMURA *and* THOMAS HEATH
Washington Post Staff Writers

The president of Major League Baseball last night called the District's legislation for a new stadium "wholly unacceptable" and halted all business and promotional activities for the Washington Nationals until further notice.

Baseball's aggressive response came at the end of a day in which city officials, business leaders and fans contemplated the potential impact of the D.C. Council's decision Tuesday to dramatically alter an agreement negotiated over several months.

Robert A. DuPuy, baseball's president, appeared to rule out renegotiating with the city. In a statement released last night, DuPuy said the council's decision to require private funds to pay for half the cost of building a stadium "does not reflect the agreement we signed and relied upon."

On the day when the Nationals had planned to unveil new uniforms, baseball instead said it will shut the one store selling Nationals merchandise. DuPuy, citing "the present uncertainty," also told fans that the Nationals would offer refunds on deposits for season tickets.

A baseball official, asked last night if the former Montreal Expos would still play at Robert F. Kennedy Memorial Stadium in the spring, said even the short-term future of the team in Washington is in peril if the deal falls apart. The D.C. Sports and Entertainment Commission has already hired consultants and begun preliminary work as part of an $18.5 million renovation.

If the council's legislation stands, the baseball official said of playing at RFK, "it's fair to assume that's out of the question."

At the John A. Wilson Building, anxiety over the future of baseball in Washington was evident all day. Mayor Anthony A. Williams (D) pronounced during his morning news conference that the deal was "in great, great jeopardy." Council Chairman Linda W. Cropp (D), the architect of the legislative amendment that required private funding, said she was "looking to reduce the cost and risk for the District."

See **BASEBALL**, *A18, Col. 3*

■ **Where D.C.'s bid for baseball might go from here.** | *Page A18*

■ **Fans voice support and worries over team.** | *Page B1*

■ **Council chairman defends her vote.** | *Page C1*

■ **The Expos-Nationals players are back in limbo.** | *Page D1*

Local Officials' Salaries Vault Past $200,000

Competitive Job Market Benefits Top-Tier Appointees

By PAUL SCHWARTZMAN
Washington Post Staff Writer

The $200,000 annual salary, once regarded as an extravagance in local government, is now commanded by a growing number of officials across the Washington region, according to a review of payrolls by The Washington Post.

School superintendents receive the highest salaries, as much as $250,000 annually, which are boosted by performance bonuses and benefit packages that can add tens of thousands of dollars to their compensation. They are followed closely by county administrators, police chiefs and other senior appointees, with salaries approaching or even exceeding $200,000.

Martin J. Briley, Prince William County's economic development director, for example, was paid $234,000 in 2004. Bruce Romer, Montgomery County's chief administrative officer, made $208,000. Anthony H. Griffin, Fairfax's appointed county executive, received nearly $195,000. And D.C. Police Chief Charles H. Ramsey, the region's best-paid local law enforcement official, made $175,000.

The salaries are greater than those of top elected officials, including D.C. Mayor Anthony A. Williams (D), $145,000; Montgomery County Executive Douglas M. Duncan (D), $143,000; and Prince George's County Executive Jack B. Johnson (D), $132,000.

Penelope A. Gross, a Fairfax County super-

See **SALARIES**, *A14, Col. 1*

Pay Scrutinized in the Extras

A detailed look at how much local governments pay top officials and other employees in jurisdictions across the region.

EXTRAS, *Behind Home*

Returning to a Home on the Range

Buffalo Being Moved from Calif. Island to S.D. Land of Ancestors

By AMY ARGETSINGER
Washington Post Staff Writer

AVALON, Calif., Dec. 15—Like so many settlers of this state, they came from sturdy midwestern stock, not really meant for the sun and salt air but lured out here by the silver screen.

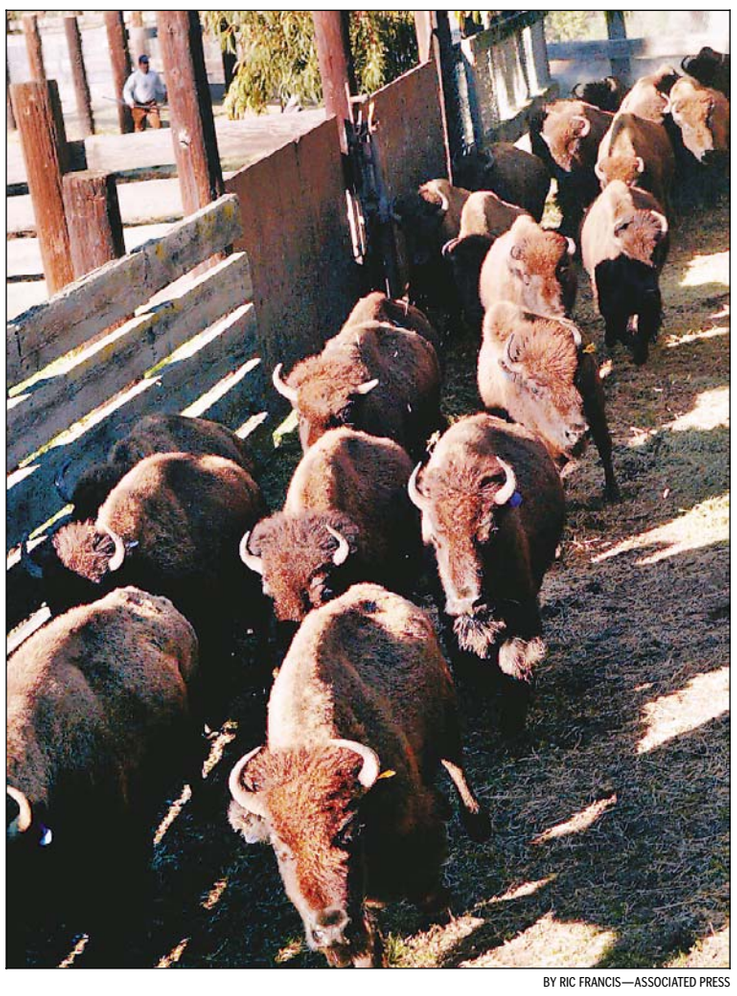
They never became stars, of course. Once Hollywood was done with them, they were stranded, with no way home. But surprisingly, they managed to eke out a new life for themselves here. In fact, they thrived all too well—all over the verdant slopes, delicate shores and winding roadways of Santa Catalina Island.

Fourteen buffalo that were shipped here about 80 years ago to play bit parts in a silent film spawned a herd that quickly grew to as many as 500 at one point.

On Wednesday, about 100 were rounded up to make the return trip their ancestors never made—to a Lakota Indian reservation in South Dakota, in an arrangement designed to relieve the overstressed island and to replenish the thinning ranks of bison in their native Great Plains. In a ceremony to see them off, a leader of Catalina's indigenous Tongva tribe raised a large feathered talisman to bless the beasts.

"This is a very special day for these four-legged animals," said

See **BUFFALO**, *A16, Col. 1*



BY RIC FRANCIS—ASSOCIATED PRESS

One hundred buffalo are being moved from Santa Catalina Island to thin the herd and to replenish the population in their native Great Plains.

Time Warner Settles AOL Cases For $510 Million

By DAVID A. VISE
Washington Post Staff Writer

Time Warner Inc. yesterday agreed to pay $510 million to settle criminal and civil charges stemming from an accounting scandal at its America Online division, moving to end a messy affair that tarnished its image and impeded its business after its merger with AOL in 2001.

Both Time Warner and Dulles-based AOL pledged to cooperate in ongoing civil and criminal investigations of individuals, and to clean up various accounting and internal practices at the Internet company. In return, Time Warner avoided a criminal prosecution and appears on track to settle civil allegations by the Securities and Exchange Commission without admitting or denying wrongdoing. The SEC has yet to approve a proposed settlement.

Deputy Attorney General James B. Comey Jr. warned that Time Warner and AOL could still face criminal charges if the companies do not cooperate fully with the investigations. But he said the gov-

See **TIME WARNER**, *A13, Col. 1*

Many FDA Scientists Had Drug Concerns, 2002 Survey Shows

By MARC KAUFMAN
Washington Post Staff Writer

Almost one-fifth of the Food and Drug Administration scientists surveyed two years ago as part of an official review said they had been pressured to recommend approval of a new drug despite reservations about its safety, effectiveness or quality.

The survey of almost 400 scientists also found that a majority had significant doubts about the adequacy of federal programs to monitor prescription drugs once they are on the market, and that more than a third were not particularly confident of the agency's ability to assess the safety of a drug.

The results of the survey, conducted by the Department of Health and Human Services' inspector general, appear to support some portions of the controversial Senate testimony last month by FDA safety officer David J. Graham. The 20-year agency veteran told senators that the FDA was unable to keep some unsafe drugs off the market, and that scientists who dissented about drug safety

See **FDA**, *A10, Col. 1*

INSIDE

Missile Defense Test Fails

The effort to build a missile defense system suffered a setback when an interceptor missile failed to launch.

NATION, *Page A5*

The Post on the Internet:
washingtonpost.com

Pain Doctor Convicted of Drug Charges

Va. Man Faces Possible Life Term on Trafficking Counts

By JERRY MARKON
Washington Post Staff Writer

A federal jury convicted a prominent former pain doctor on drug trafficking charges yesterday, siding with prosecutors in an increasingly contentious nationwide dispute over whether prescribing large doses of powerful narcotics is criminal behavior or good medicine.

Jurors found William E. Hurwitz guilty of running a drug conspiracy out of his McLean office, convicting him on 50 counts—including trafficking that caused the death of one patient and seriously injured two others. They acquitted him of nine other counts and deadlocked on the final three in the 62-count indictment.

U.S. District Judge Leonard D. Wexler ordered the jury back to the federal courthouse in Alexandria to resume deliberations today. He then revoked Hurwitz's $2 million bail. Hurwitz removed his tie, handed the change in his pockets to his attorneys and walked out of the courtroom in the custody of U.S. marshals. He had bowed his head slightly when the verdict was read.

The convictions marked the downfall of a

See **HURWITZ**, *A16, Col. 4*

William E. Hurwitz is "a hero and a medical pioneer," said Siobhan Reynolds of the Pain Relief Network.

Fannie Mae Told to Correct Accounting

FANNIE, *From A1*

are committed to taking the steps necessary to comply with our minimum capital requirement."

Nicolaisen said Fannie Mae did not meet the requirements for "hedge accounting," which allows companies under stringent conditions to exclude from reported earnings changes in the value of financial instruments known as derivatives. Fannie has argued that the rule was misguided.

The total size of the potential hedge accounting correction Fannie Mae warned of last month was $18 billion—$13.5 billion of previously unreported losses and $4.5 billion of previously unreported gains, which would net a $9 billion reduction in past earnings.

"It's the kind of thing that shakes your confidence in financial statements," said Charles W. Mulford, an accounting professor at the Georgia Institute of Technology.

Rep. Michael G. Oxley (R-Ohio), chairman of the House Financial Services Committee, said in a statement, "I am deeply disturbed that investors, the markets, and Congress were misled by deceptive practices at Fannie Mae." He said he intends to hold hearings early next year.

Fannie's accounting remains the subject of a criminal investigation by the Justice Department, a civil investigation by the SEC's enforcement division, class-action lawsuits by shareholders, and an outside review commissioned by Fannie's board.

Defending the company at a House hearing in October, chairman and chief executive Franklin D. Raines said the accounting rules at issue "are highly complex and require determinations over which experts often disagree." Fannie "intended to do the right thing and we took care to do the right thing," said Raines, who headed the Office of Management and Budget in the Clinton administration.

But the director of the Office of Federal Housing Enterprise Oversight, which had spent months scrutinizing Fannie's accounting and produced a scathing 198-page report in September, called the company's violations "pervasive and willful."

"It's not a matter where they made a good-faith effort to try to comply with the rules," OFHEO Director Armando Falcon Jr. told lawmakers. "They did not comply with rules that they clearly understood."

OFHEO alleged that, in one instance in 1998, Fannie delayed booking $200 million of expenses, enabling top executives to receive millions of dollars of bonuses.

The SEC official's assessment was a vindication of OFHEO, which, according to comments by its deputy director in a recent report by the inspector general of the Department of Housing and Urban Development, was humiliated last year when Fannie's rival, Freddie Mac, admitted that its financial reports contained billions of dollars of accounting errors and distortions. OFHEO had given Freddie Mac's auditing and internal controls a favorable review shortly before Freddie disclosed that it had problems.

The scandal at Freddie prompted OFHEO to take a closer look at Fannie Mae, with help from the accounting firm Deloitte & Touche LLP. During the scandal at Freddie, Raines vehemently denied that Fannie had similar problems and complained that Fannie was being tarred with the same brush.

Fannie's allies on Capitol Hill have accused OFHEO of pursuing its examination of Fannie in an overzealous and abusive manner.

Raines reminded members of Congress at the October hearing that he had certified the company's financial statements.

Under a law passed in the aftermath of the accounting scandal at Enron Corp., if a company corrects its past financial reports, its chief executive and chief financial officer can be required to give up bonuses, stock gains and other compensation tied to the false financial reports.

Chartered by the government in the 1930s, Fannie Mae plays a behind-the-scenes role in the mortgage business. It borrows money from investors by issuing bonds and purchases mortgages from lenders, giving them cash to make more loans. It also packages mortgages into securities that can be sold to investors.

Freddie Mac, which disclosed its problems in early 2003, has yet to resume issuing quarterly financial reports on a timely basis and has spent hundreds of millions of dollars on the clean up.

Federal Reserve Chairman Alan Greenspan and other government officials have called for tighter restraints on Fannie and Freddie, saying that, if left unchecked, they could expose the government to a potential bailout.

The SEC issued its statement as Fannie Mae employees were attending a company holiday party.

■ **Fannie Mae objected to derivatives rules.** | *Page E1*

Accounting Scandal Costs Time Warner $510 Million

TIME WARNER, *From A1*

ernment was willing to accept a settlement to avoid harming those not directly involved.

"The government has achieved the result that minimizes the collateral damage to shareholders and employees, while imposing appropriate punishment and protecting the rights of victims," Comey said at a news conference.

The settlement, he said, would allow AOL to "make amends for its conduct and clean up its act, in return for a stiff penalty and far-reaching reforms."

Time Warner executives seemed pleased with the outcome, which would allow the company to put aside its legal troubles and focus on rebuilding AOL and strengthening its cable television, movie and publishing divisions.

"While there are still challenges ahead, the steps we announced today will help to remove a cloud that has been hanging over the company for some time now," Time Warner chairman and chief executive Richard D. Parsons wrote in a memo to employees.

The government blocked Time Warner's ability to raise money through new stock or bonds as it investigated a series of unconventional deals at AOL that helped pump up advertising and e-commerce revenue before and after the merger in January 2001. Several of the deals were first detailed in The Washington Post in July 2002.

The Justice Department yesterday charged America Online with aiding and abetting securities fraud in one of those deals, for allegedly helping a small business software company, PurchasePro.com Inc., inflate its revenue through sham transactions. PurchasePro, in turn, helped AOL boost it revenue.

Four former executives at the now-defunct Las Vegas company agreed to plead guilty to criminal charges arising from their involvement. As part of yesterday's settlement, Justice Department officials said they would defer prosecution of America Online for two years, and would drop the charges altogether pending the company's cooperation.

The Justice Department said "six or more" unidentified AOL executives were involved in the scheme with PurchasePro, in which both companies overstated ad revenue.

Time Warner stock, which had been around $16 a share for months, began rising this week as word of the impending settlement spread on Wall Street. Yesterday, the company's stock closed at $19.38 a share, unchanged from the day before.

Time Warner still faces lawsuits from shareholders who lost billions of dollars during the accounting scandal. The company has not predicted how much it would cost to settle that litigation.

The $510 million in Time Warner penalties and fines would be divided between the Justice Department, the SEC and a fund for shareholders who lost money on Time Warner stock. While the Justice Department agreement is final, the company's proposed deal with the enforcement division staff of the SEC must still be reviewed by the agency's five commissioners, who can accept, reject or amend the proposal. Their review could last several months.

If the proposal is approved by the commissioners, the company would pay a $300 million penalty and appoint an independent examiner to review online advertising deals and other transactions between 1999 and 2002, Time Warner said in a written statement.

Under the terms of the agreements, Time Warner also would pay $60 million in fines to the Justice Department, and put $150 million more into a civil litigation fund for shareholders. That same fund also would be used to cover various government expenses from the investigations.

Sources familiar with the negotiations between the company and the government said last month that the settlement might be for as much as $750 million, but in the end, the total was closer to the $500 million Time Warner has already set aside in reserve.

An agreement with the SEC would free Time Warner to once again issue stock and bonds to make acquisitions. Parsons has said the company's top priorities are to buy cable television properties and find other ways to increase value for shareholders.

"We are pleased to have made progress toward resolving the government investigations of the company. We will continue to work with the SEC staff to finalize our proposed agreement, and we are committed to fulfilling our obligations to the government," Time Warner corporate spokesman Edward I. Adler said.

Time Warner lawyers sought language in the settlement agreement that would minimize the cost of resolving lawsuits filed by shareholders of AOL and Time Warner.

After revelations of its unconventional deals surfaced in July 2002, Time Warner conducted an internal investigation of AOL and turned over millions of pages of documents to the government. The company eventually restated $190 million in AOL revenue from questionable ad deals with other firms. Later, Time Warner restated financial results from AOL Europe after regulators complained that the Internet company had tried to shield the parent company from its losses.

The SEC's chief accountant has accused both Time Warner and AOL of improperly counting $400 million from German media giant Bertelsmann AG as AOL ad revenue when some of the money reflected payments for other purposes. Without admitting or denying wrongdoing, Time Warner agreed to adopt the SEC's suggestion for accounting for the transactions. Time Warner also agreed to restate a $30 million from two other advertising deals involving AOL and its customers.

Further restatements may be required, depending on the outcome of an independent review to be conducted of "a limited number" of AOL advertising deals from 1999 to 2002, the company said in a filing with the SEC.

Also, Time Warner's chief financial officer, Wayne H. Pace, and two other Time Warner finance executives involved in the Bertelsmann accounting would be subject to administrative proceedings under the proposed SEC settlement.

Pace and the others would neither admit nor deny wrongdoing under the proposal, and would continue to work for Time Warner in their current jobs.

The investigations have taken their toll on Time Warner. America Online became such a liability that the "AOL" was scratched from the parent company's corporate name. AOL co-founder Stephen M. Case resigned as chairman of the merged company (he remains a member of the board of directors) and AOL became a mere division, even though the Internet firm originally had used its stock to buy Time Warner.

With the number of AOL Internet service subscribers dropping, the company is trying to make its AOL.com site attractive to a broader audience of Web users. AOL plans to sell ads and various services on the revamped site.

Jonathan F. Miller, chief executive of the America Online unit, took solace in the fact that the company survived the long-running investigation, which some had predicted would bring about its demise, particularly given its underlying business troubles.

Miller said he thought the settlement would effectively resolve the criminal investigation of AOL.

"We will work with the independent monitor appointed as part of our agreement with the Department of Justice," Miller wrote to AOL employees. "In short, we will do what it takes to make sure that AOL puts this matter behind us with contrition and resolve."

Staff writer Mike Musgrove contributed to this report.

MORE COVERAGE

Big Deal Became A Lost Horizon

Leaders of America Online and Time Warner have taken strange paths since they merged their companies.

BUSINESS, *Page F1*

Settlement Will Let Company Move On

For Time Warner, it may be worth $510 million to regain its corporate freedom.

BUSINESS, *Page E1*

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The Washington Post

BUSINESS

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Stocks
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Tech Thursday

Thursday, December 16, 2004

M2

TECH THURSDAY

The Business of Technology

.com

Leslie Walker

The Shipping News? Time's Almost Up

The e-mail offers are coming fast and furious.

"There's still time," screamed one that arrived in my inbox Tuesday, promising 20 percent off any item or free shipping at Art.com. I had only to enter "Santa" or "free shipping" in a special box at checkout—and order by Dec. 16.

"Christmas Delivery—Guaranteed!" shrieked another arriving yesterday from Overstock.com. It offered $1 shipping on any order, amounting to about $2 off Overstock's standard shipping price of $2.95. That deal also expires tonight.

Such fine-print deadlines are deal-breakers for Internet holiday shoppers, especially with only nine days left until Christmas. The reality is that you do *not* have much time left for Internet shopping, unless you want to break the piggy bank for expedited shipping of gifts.

While offline shoppers still have eight full shopping days to fight the grumpy throngs at area malls, online shoppers have half that—or less—to take advantage of free and low-cost shipping.

Today through Saturday are the cutoff dates for standard shipping at most Internet retailers in order to guarantee delivery by Dec. 24. Since free-delivery offers usually apply only to standard shipping, which takes four to seven days, that means Internet orders get more expensive next week when people starting paying extra for second-day air or next-day service to guarantee Christmas delivery.

"This is the big crunch week for online shopping," said Lauren Freedman, president of Chicago-based E-Tailing Group Inc., a consultant to the retailing industry. "Next week you will have a few players who can still handle ground shipping, then everything will move into expedited shipping."

There could be some disappointed

See **.COM**, *E6, Col. 1*

THE DOWNLOAD

Shannon Henry

Wireless Abounds; The Focus Now Is on Improving It

Nextel was the big story in telecommunications yesterday, thanks to the Reston company's mega-merger with Sprint, but the future of wireless may be percolating in dozens of Washington area start-ups.

"It is no longer the network that is the key, it is the edge that is the key," said **Tom Wheeler**, a venture capitalist with **Core Capital Partners** in Washington and the former president and chief executive of the **Cellular Telecommunications & Internet Association**.

In other words, Wheeler said, it will be less about nuts-and-bolts cellular systems and more about imaginative marketing and innovative services.

Washington's new generation of wireless companies competing to develop such offerings includes **Ztango** of Reston, which provides wireless messaging and content such as musical ring tones, and Washington-based wireless services and devices seller **InPhonic**, which recently went public. Then there are wireless security firms **Koolspan** in North Bethesda and **Trust Digital** in McLean. **Cibernet** in Bethesda sells billing services to the wireless industry. And **Defywire**, based in Herndon, creates wireless-services software for large corporations.

Some of the area's wireless experts and entrepreneurs gathered recently at the Ritz-Carlton in Tysons Corner for a roundtable discussion titled "What's Next in Wireless?"

The panelists agreed that one of the most interesting and potentially lucrative wireless niches will be "micropayments," finding ways to use a cell phone to pay small amounts, such as $1 or $2, for a new ring tone or a game. "That's a gigantic opportunity," said **Mark Ein**, founder of District-based venture capital firm **Venturehouse Group.**

See **THE DOWNLOAD**, *E6, Col. 1*

Sprint, Nextel Detail Merger Agreement

By Ben White *and* Ellen McCarthy
Washington Post Staff Writers

NEW YORK, Dec. 15—Sprint Corp. and Nextel Communications Inc. on Wednesday formally announced a $35 billion merger agreement, offering fresh details on how the corporate combination creating the nation's third-largest wireless company would affect employees and consumers.

The companies said consumers would be able to keep their existing phones and service plans. Both companies' networks would be maintained for at least the next few years, with some rapid upgrades to make communications between them quicker and easier. In two or three years, the merged firm plans to offer a single handset on a single network that would combine Nextel's popular push-to-talk function with high-speed wireless connections to the Internet.

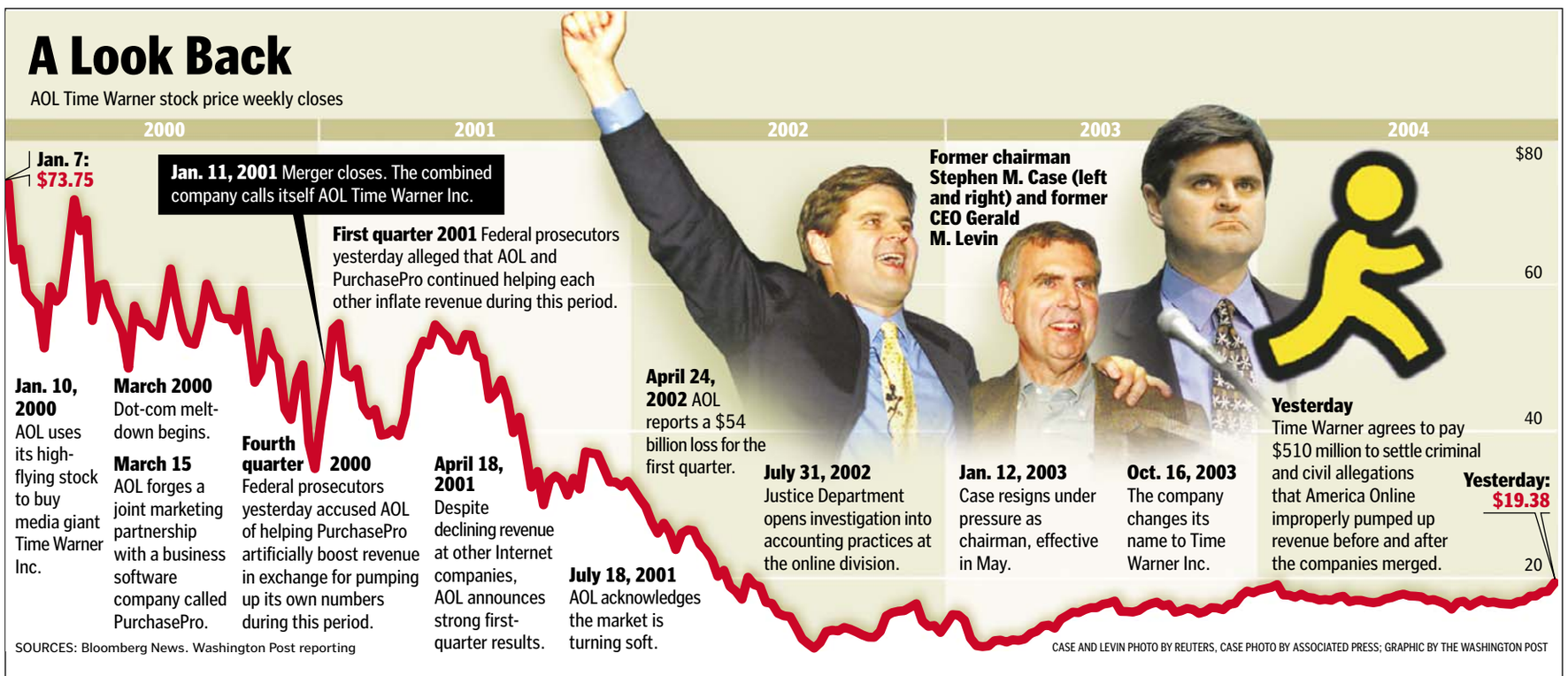
Executives at both companies said the merger would result in layoffs—including some among Nextel's 3,500 employees in the Washington area and Sprint's 1,600 employees in the area—to achieve a promised $12 billion in cost cuts. The companies predicted the merger, which requires shareholder and regulatory approval, would close in the second half of next year.

The new company, to be named Sprint Nextel, would have its executive headquarters in Reston, where Nextel is currently based, and its operations center in Sprint's hometown, Overland Park, Kan. Sprint chief executive Gary D. Forsee is to move to Reston and serve as chief exec-

See **MERGER**, *E7, Col. 1*

■ **Answers for curious customers of Sprint and Nextel.** | *Page E7*

■ **Uncertainty in the air at Nextel headquarters in Reston.** | *Page E7*



Time Warner Closes AOL Chapter

Players in Dazzling Deal Moved Into New Ventures

By Alec Klein
Washington Post Staff Writer

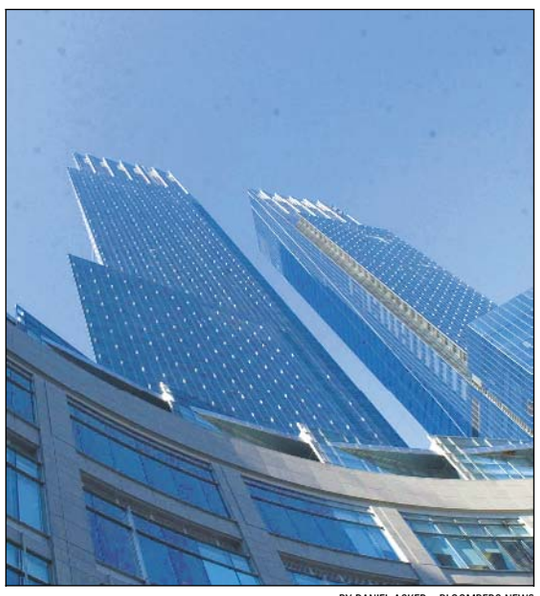
Nearly five years ago, several top executives involved in America Online's takeover of Time Warner were hailed as visionaries who had engineered the largest merger in U.S. history, a media powerhouse that would change our lives.

As it turned out, the merger did more to alter their lives. One of the men behind the $112 billion deal now is into new-age mental health. Another is spending his millions on a start-up travel company. A third is pitching bison burgers.

Others continue to be the subjects of federal probes, apart from yesterday's announcement by the Justice Department that Time Warner Inc. has agreed to pay $210 million to settle charges that its America Online unit aided and abetted securities fraud. Time Warner has proposed paying an additional $300 million to settle civil charges.

The settlements are a far cry from the situation just a few years ago when, at the height of the dot-com mania, AOL was at the vanguard of the Internet revolution, and

See **PLAYERS**, *E5, Col. 1*



BY DANIEL ACKER—BLOOMBERG NEWS

Time Warner Center in New York embodied lofty expectations for AOL, Time Warner leaders in 2001.

■ **SEC fines have increased, causing debate among commissioners.** | *Page E5*

Settlement Might Make Acquisitions More Likely

By Ariana Eunjung Cha
Washington Post Staff Writer

Under normal circumstances, news that a company may have to pay $510 million in fines would be tantamount to disaster. But in Time Warner Inc.'s case, investors celebrated, pushing its share price temporarily to a 52-week high yesterday afternoon.

For more than two years, the New York-based media giant has been grappling with the uncertainty of investigations by the Department of Justice and the Securities and Exchange Commission into possible bookkeeping irregularities at America Online Inc. during the dot-com era. Under the deals announced yesterday, Time Warner would pay $360 million in fines and $150 million for a settlement fund.

SEC members must still approve that agency's part of the agreement. But conclusion of the investigations, analysts said, would allow the company to operate more freely and aggressively again. Perhaps more important, settlements would help Time Warner further distance it from its ill-fated January 2001 merger with Dulles-based

See **INVESTORS**, *E5, Col 1*

FCC Considers Cell Phone Use On Airplanes

By Frank Ahrens
Washington Post Staff Writer

Air travelers moved one step closer to being able to talk on cell phones and surf the Internet from laptops while in flight, thanks to votes by the Federal Communications Commission yesterday.

Cell phone use is banned on airplanes by two federal agencies for separate reasons. The Federal Aviation Administration fears the wireless signals could interfere with an airplane's avionics and communications equipment.

The FCC bans in-flight use because cell phones can communicate with more than one cell tower when in the air. This could lead to disruption of service for cell phones on the ground, which use only one tower at a time.

But the commission thinks cell phone technology has advanced far enough in recent years to minimize such disruption of ground service. Yesterday, the FCC voted to consider lifting its ban, and it will begin taking comments from businesses and travelers over the next few months.

The FAA, meanwhile, has commissioned a study that could eventually result in its cell phone ban being lifted. In

See **PHONES**, *E3, Col. 3*

BY DENNIS COOK—ASSOCIATED PRESS

Fannie Mae Chairman Franklin D. Raines, left, and J. Timothy Howard, the chief financial officer, testified at a House committee hearing in October.

Fannie Took the Shortcut

Company Objected to Accounting Rule

By David S. Hilzenrath
Washington Post Staff Writer

In the spring of 2000, Fannie Mae, the giant housing-finance company, was pleading with accounting rulemakers to preserve a "shortcut" around new requirements that would be costly to implement while making earnings less predictable.

"Fannie Mae, along with many other entities, intends to rely on the 'shortcut' method," Chief Financial Officer J. Timothy Howard wrote in a letter to the rulemaking board. The rulemakers preserved the shortcut—with restrictions—and, in the years that followed, Fannie made extensive use of it.

The requirements Fannie wanted to bypass are at the heart of last night's finding by the Securities and Exchange Commission's chief accountant that Fannie Mae should correct its earnings for the past several years. Fannie has estimated that such a restatement would wipe out $9 billion—38 percent of its profit since the rule went into effect in 2001.

Fannie's alleged abuse of the shortcut was one of the main issues its regulator, the Office of Federal Housing Enterprise Oversight, cited in a Sep-

See **HEDGING**, *E4, Col. 1*

Small Telecoms Losing Mandated Line Discounts

By Frank Ahrens
Washington Post Staff Writer

Millions of residential and small-business customers may face higher phone bills in coming months as a result of a vote by the Federal Communications Commission yesterday to phase out discounts that major regional phone companies must give rivals that rent space on the big companies' lines.

However, the agency set limits on those price increases and predicted that consumers will benefit in the long run from increased choices and competition for phone service, as cable telephony and Internet phone service take off.

The Telecommunications Act of 1996 required major regional phone companies, such as Verizon Communications Inc. and SBC Communications Inc., to rent space on their phone lines at discount rates to smaller competitors, such as MCI Inc. and AT&T Corp., that did not own their own lines. The sharing process is called "unbundling," and the rules governing it have been controversial and unstable.

Three times since, the FCC has attempted to write unbundling rules, and each time federal courts—including the Supreme Court—have sent the rules

See **FCC**, *E4, Col. 5*

DOW 10,691.45
UP 15.00, 0.1%

NASDAQ 2162.55
UP 2.71, 0.1%

STANDARD & POOR'S 500
1205.72, UP 2.34, 0.2%

WASH. POST-BLOOMBERG REGIONAL
267.51, UP 1.98, 0.7%

10-YEAR TREASURY NOTE
UP $3.75 PER $1,000, 4.08% YIELD

CURRENCIES
104.23 YEN=$1, EURO=$1.3412

Rules Came From Use Of Derivatives in 1990s

HEDGING, *From E1*

tember report that accused the District-based company of pervasive accounting violations. The issue involves Fannie's treatment of complex financial instruments known as derivatives, which it uses to hedge against movements in interest rates.

Fannie's earlier lobbying of the rulemakers shows that the company was closely following developments at the Financial Accounting Standards Board as it drafted the controversial rule during the 1990s.

In testimony to Congress last month defending Fannie Mae's accounting, chief executive Franklin D. Raines said, in effect, that the issues fall in a gray zone. He said the dispute involves complex decisions about which experts often disagree.

OFHEO Director Armando Falcon Jr. told the same hearing that Fannie knew the rules and deliberately violated them. He said the company committed "black and white" accounting violations.

"They fully understood the rules. That's not in doubt," Wanda DeLeo, OFHEO's chief accountant, added at the hearing. "Their systems are not capable at this point of doing what we're calling long-haul accounting. . . . They could have built systems to do that, but that was not done."

In its September report on Fannie's accounting, OFHEO said, "At times, even though the FASB had rejected the requested treatment, Fannie Mae disregarded the FASB's guidance and accounted for their transactions the way they had originally proposed. "This sheds some light on the culture and attitude within Fannie Mae—a determination to do things 'their way.' "

Accounting experts agree that the rule at issue, a 213-page opus known as FAS 133, is complex. But some experts interviewed for this story said a particular provision at the heart of OFHEO's criticism is clear-cut.

Commenting on the rule—without judging the way Fannie applied it—some specialists echoed the regulator's phrase, describing a key restriction on use of the shortcut as "black and white."

Fannie Mae spokesman Charles V. Greener declined to comment for this story.

To understand the debate over Fannie Mae's accounting, it helps to return to the 1990s. That's when the esoteric financial instruments known as derivatives were assuming a powerful role in the financial system and contributing to a series of financial disasters.

Derivatives are financial contracts whose terms are derived from the value of other benchmarks, such as commodity prices, stock prices or interest rates. They allow companies to place bets on the direction in which markets will move.

Derivatives can be used to speculate for profit or to hedge against risks. For example, if a company has investments that will decline in value if interest rates rise, it can protect itself by investing in derivatives that will increase in value if interest rates rise. In a perfect hedge, the derivative, and the risk it is meant to mitigate, balance each other like people of equal weight on opposite ends of a seesaw.

The nature of Fannie's business makes it a heavy user of derivatives. Chartered by the government to ensure that lenders have enough funds to meet the demand for home mortgages, Fannie borrows money by issuing bonds and uses that money to purchase mortgages from lenders. The company pays interest to its bondholders and receives interest payments on mortgages, leaving it vulnerable to both upward and downward swings in interest rates.

For example, if Fannie is paying 6 percent interest to bondholders and rates fall to 5 percent, Fannie is stuck paying an above-market rate. If Fannie is receiving 5 percent interest on mortgages and rates climb to 6 percent, Fannie is stuck receiving a below-market return on its investment. And, if interest rates fall significantly, as they have in recent years, homeowners will refinance their loans, prematurely terminating the mortgages in Fannie's portfolio and cutting short the stream of interest Fannie would have received at the higher rate.

Derivatives help Fannie modulate the effect of rate fluctuations. In a typical arrangement known as a "swap," Fannie might agree to pay a fixed interest rate to a counterparty for a fixed number of years in return for so-called variable interest payments, which change with the prevailing rates.

In the 1990s, Wall Street firms were making huge profits selling derivatives, and some big users of the devices such as Procter & Gamble Co. surprised the public with disclosures that they had incurred large losses on derivatives. In California, such losses drove Orange County into bankruptcy protection.

When companies use derivatives to speculate, the risks can be huge—it is like gambling with borrowed money, which enables the gambler to place outsized bets.

BY LARRY DOWNING—REUTERS

Fannie knew the rules and broke them, OFHEO Director Armando Falcon Jr. said.

In the 1990s, concern grew that derivatives posed hidden risks for shareholders. Accounting rulemakers worried that companies could use derivatives to manipulate earnings. Rulemakers also worried that companies were using different methods to account for derivatives, making it hard to compare businesses' performance.

To standardize accounting for derivatives and to make them more transparent to the public, FASB drafted the rule that came to be known as FAS 133. Its main thrust was to require companies to include in their quarterly earnings the amount by which their derivatives rose or fell in value, even if the contracts remained open and the company had not yet locked in the gain or loss.

Heavy users such as Fannie Mae, which strives to deliver the steady earnings growth that many investors favor, protested that those quarterly adjustments threatened to cause artificial spikes in the company's earnings. The unpredictability could require the company to keep more capital in reserve against potential financial shocks, thereby cutting into profit.

To accommodate such concerns, FASB carved out a major exception. It declared that companies could exclude gains and losses on derivatives from earnings if they could prove that they were using the derivatives to balance risks and not to speculate. To qualify for that special treatment, known as hedge accounting, a company must document that the derivative was paired with a specific asset or liability.

In addition, the rule said, the company must conduct quarterly tests to confirm that the derivative continues to counter the risk. To the extent that the derivative has fallen out of balance with that risk, the company must adjust its earnings. The testing requirement can be a costly burden, especially for companies using derivatives on a grand scale.

But again, FASB provided an exception. The rulemakers declared that, under certain stringent conditions, companies could simply assume that their hedges remained perfectly effective, avoid the extensive quarterly testing, and exclude the gains or losses from earnings.

In accounting parlance, that is known as taking the "shortcut" instead of the "long haul."

The testing and documentation requirements of long-haul accounting were meant to prevent companies from cherry-picking—waiting to see how derivatives perform and then claiming profit from the successful transactions while saying the losers were actually hedges and should not be counted against earnings, said Daniel B. Thornton, an accounting professor at Queen's University in Kingston, Ontario, and a former academic fellow at the SEC.

To take the shortcut, companies must show that when a hedge was put in place, the value of the derivative was zero—the normal starting point for a new hedge. OFHEO alleges that Fannie routinely violated that condition when it changed financial strategies and, with no new testing or proof of effectiveness, took derivatives that were initially paired with one liability and paired them with another.

OFHEO and some private-sector experts say that when derivatives from preexisting hedge arrangements are recycled into new arrangements, only by coincidence would the value of the derivative be zero.

Thornton of Queen's University put the odds at "one chance in a billion that it would stay at zero for the whole time, a trillion even."

Based on that requirement, Impac Mortgage Holdings Inc. recently said it had improperly accounted for derivatives and corrected its financial statements. "It's very clear in the literature that if the value of the hedge is not zero at the time you designate it, you cannot use the shortcut method," said Impac's chief financial officer, Richard J. Johnson. "That's black and white."

Robert C. Wilkins, a senior project manager at FASB who helped develop the rule, said he thought the requirement was well understood—partly because companies complained about it.

As originally adopted, FAS 133 would have allowed Fannie to use the shortcut when it was reusing a derivative from a discontinued hedge in combination with a new derivative. To illustrate that point, the rule presented a scenario almost identical to one Fannie had submitted in a 1997 letter to FASB.

However, before the rule took effect, FASB changed its mind and passed an amendment, FAS 138, deleting the wording that would have allowed that use of the shortcut.

Jonathan Boyles, Fannie's senior vice president for financial standards and corporate tax, told regulators that Fannie knew the sentence was deleted but decided to use the shortcut anyway, according to the OFHEO report.

Fannie's auditor, KPMG LLP, flagged Fannie's use of the shortcut as a "difference"—a point of concern in auditor jargon—when it reviewed the company's books, Boyles told regulators. But the company estimated that the accounting effect of using the long haul instead of the shortcut would be "minor" and "immaterial," Boyles said, according to the OFHEO report.

Regulators faulted Fannie's conclusion that the stakes were insignificant. The impact on company earnings, the agency said in its report, "could be in the billions of dollars," within the range of the potential $9 billion overall correction Fannie described.

Chronology

- **July 14, 2003:** Federal regulators from the Office of Federal Housing Oversight, already investigating accounting errors at mortgage lending giant Freddie Mac, tell Congress they plan to conduct an accounting review of Fannie Mae.
- **July 30, 2003:** Fannie Mae chief executive Franklin D. Raines says the accounting scandal at Freddie Mac has unfairly tarred his company.
- **Oct. 29, 2003:** Fannie Mae reports it made an error of more than $1 billion in its last quarterly earnings release.
- **Sept. 22, 2004:** OFHEO reports that Fannie Mae has used improper accounting methods that raise serious questions about the quality of its management.
- **Sept. 27, 2004:** Fannie Mae reaches an agreement with OFHEO to change its accounting methods in the future and to begin addressing management problems.
- **Yesterday:** The Securities and Exchange Commission says Fannie Mae should correct its past accounting, a directive that could erase 38 percent of the profit it has claimed since Jan. 1, 2001.

SOURCE: Washington Post reporting

THE WASHINGTON POST

Phone-Line Discounts to End

FCC, *From E1*

back, saying the agency did not justify them satisfactorily.

This meant that the 18 million customers who signed up for plans such as MCI's "Neighborhood" and deals offered by other smaller providers did so under unlawful plans, according to the courts.

Yesterday's action phased out unbundling in some markets but not all. It passed by a 3-to-2 vote along party lines, with Republicans supporting and Democrats opposing. The vote represents what FCC Chairman Michael K. Powell said he hoped was the final time his agency had to consider these rules.

"In 1996, no one could have guessed that nearly a decade later the FCC would be on its fourth attempt to develop local competition rules that are lawful," Powell said. "We hope to end that here and now, for the market cannot possibly continue another day plagued by an ever-shifting regulatory foundation."

Neither the regional carriers—often known as the Baby Bells—nor the smaller competitors are completely happy with yesterday's vote, which may be challenged in court, FCC officials acknowledged.

Some carriers were upset by the FCC's selective phase-out.

"SBC is pleased that the FCC took positive steps to eliminate the harmful and unlawful . . . subsidy program on a going forward basis," James C. Smith, SBC senior vice president, said in a statement yesterday. However, SBC pointed out that the FCC ignored cities such as Houston, where 10 rival carriers have their own fiber-optic networks but still rent space at subsidized rates on SBC's lines.

"Today's order clearly eliminates the most significant, and sometimes only, competitive alternative for American residential customers," Leonard J. Cali, AT&T director of federal government affairs, said in a statement. He said that AT&T's "initial estimates indicate that the FCC's decision could deny competitors access to roughly 6.7 million business lines and up to 20 percent of all business lines in the top 50 [metropolitan areas]."

The FCC told the regional carriers that they cannot raise wholesale prices to rivals by more than $1 per customer during the phase-out period, which will last until early 2006. By then, the agency hopes, carriers and rivals will negotiate their own deals, and consumers will have other options.

Democratic commissioners Jonathan S. Adelstein and Michael J. Copps voted against the rules, saying they will end competition. The vote also was opposed by some public-interest groups.

"The FCC today continued its practice of chipping away at telecommunications competition while strengthening the Bell monopoly," said Mark Cooper, research director for the Consumer Federation of America.

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The Washington Post

WASHINGTON BUSINESS

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Stocks
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Monday, December 20, 2004

DEALMAKERS

Terence O'Hara

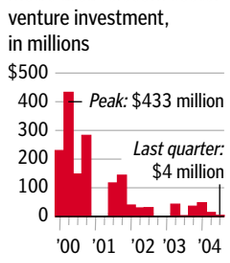
Tracking Signs Of a Rebound In Telecom

Investing in early-stage telecommunications companies in the past three years took a strong stomach. But a few local venture investors who have stuck with the sector are beginning to see signs that the indigestion may have been worth it.

It's nothing like 1999 and 2000, when telecommunications companies with no revenue and untested technology were at times valued in the billions of dollars. But after three years of dormancy, 2004 was the year that venture capital investing in telecommunications equipment, software and wireless gizmo firms became respectable again.

Troubled Industry

Metro area telecom sector venture investment, in millions



SOURCE: MoneyTree survey

"We feel very sanguine about our telecom portfolio," said **Tom Smith**, a partner at **Mid-Atlantic Venture Funds** of Reston. "All of our companies are meeting or exceeding their plans."

Sanguine may not rival "ecstatic," the word most often used in 2000 when early-stage telecoms were white hot, but Smith has a few reasons to be genuinely happy about his telecoms.

First, merger-and-acquisition activity is increasing. For example, large telecommunications equipment companies, squeezed by the drop in spending by the large phone companies in recent years, pulled back on expensive

See **DEALMAKERS**, *E3, Col. 1*

WASHINGTON INVESTING

Jerry Knight

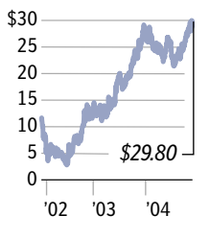
Nextel Stock Pays Off for Legg Mason Fund

The merger of Nextel and Sprint is producing handsome returns for Washington investors and Baltimore's best-known money manager.

Now approaching $30 a share, Nextel Communications Inc. stock could be bought for less than $3 in July 2002. Nextel shareholders are scheduled to get Sprint Corp. shares and a little cash for a total value of $32.50 a share if and when the merger is completed next year.

Rebound

Nextel stock price



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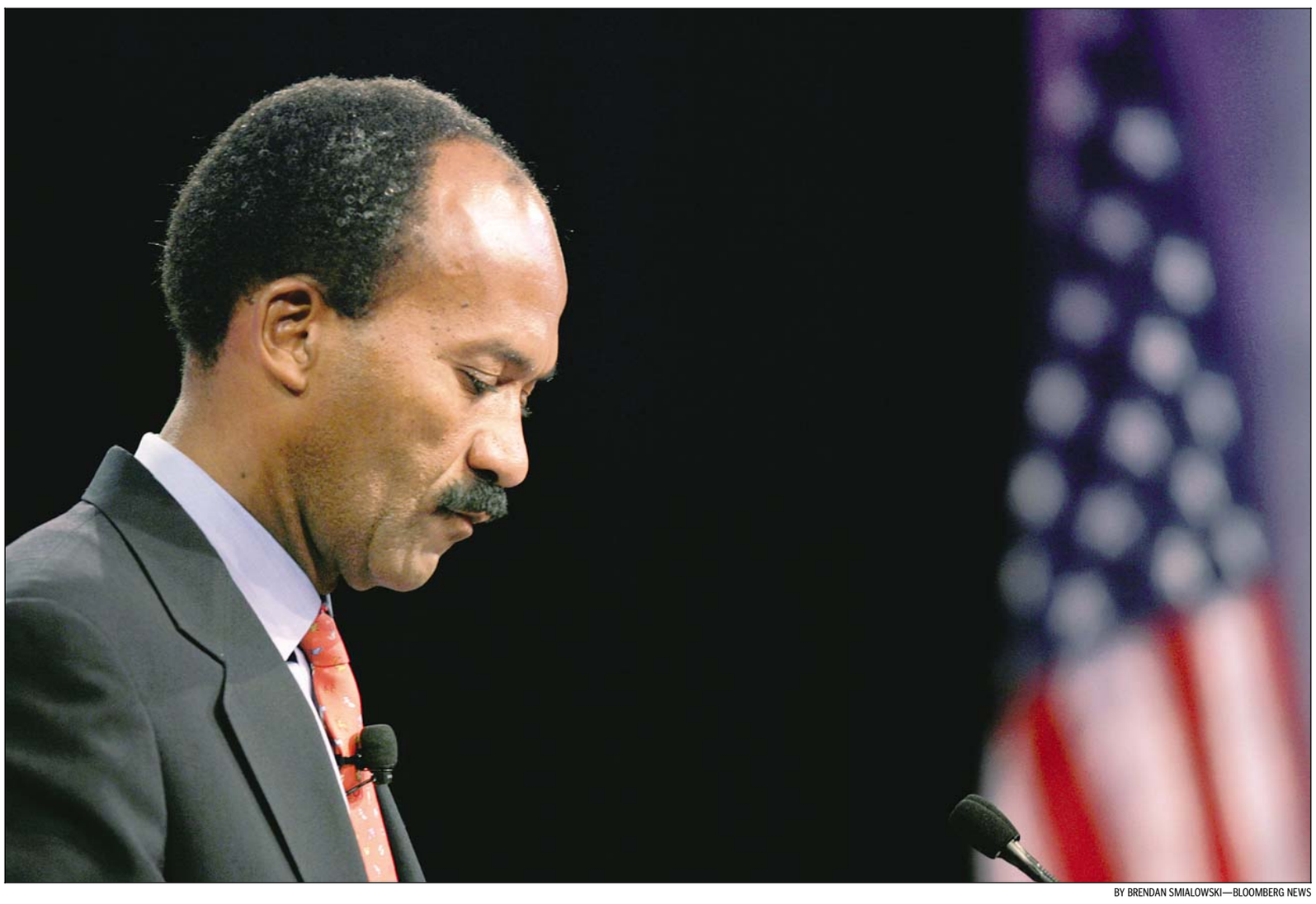
See **INVESTING**, *E5, Col. 1*

INSIDE

FALLOUT AT FANNIE MAE | *Challenging Corporate Resolve*

A Personal Test



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Raines's Future in Doubt as Company's Board Meets

By Terence O'Hara
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The Finance Chief

Executive Fought Accounting Rules That Bit Company

By Greg Schneider
Washington Post Staff Writer

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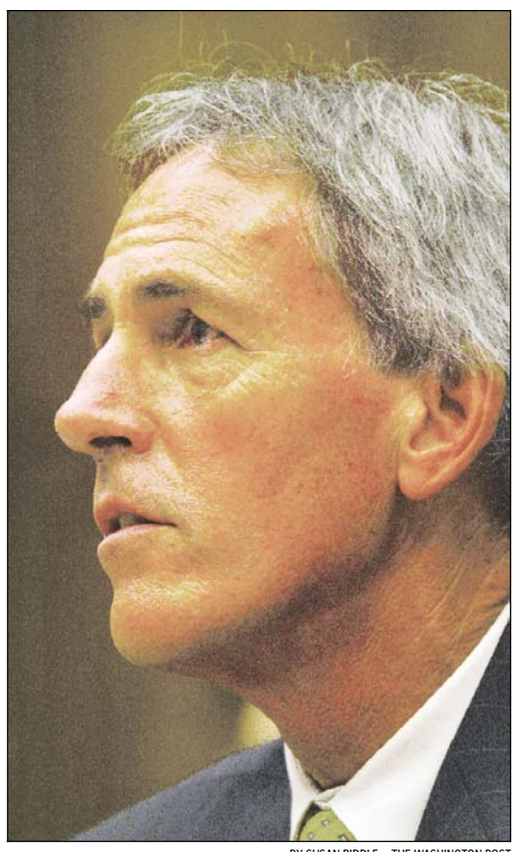

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Capitol Hill

Deep Political Support Often Blunted Efforts To Step Up Regulation

By David S. Hilzenrath
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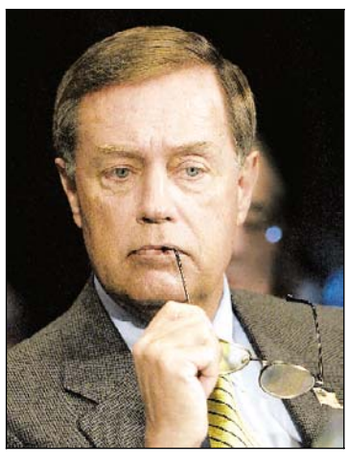
FALLOUT AT FANNIE MAE | *Challenging Corporate Resolve*

Legislative Agenda

Congress Puts New Regulator on the Fast Track



Rep. Michael G. Oxley (R-Ohio) plans hearings on a regulatory agency.

Emboldened by Fannie Mae's financial troubles, senior members of Congress and the Bush administration are expected to press hard next year to pass long-delayed legislation that would create a new federal agency to oversee the mortgage-funding giant and its smaller rival, Freddie Mac.

The measure bogged down last spring when Fannie Mae and its allies came to loggerheads with the Treasury and Housing departments over how much authority the new agency should get. For example, the administration objected to a provision, backed by Fannie Mae supporters, that would have allowed Congress a review if the regulator chose to put the company into receivership.

But now administration officials and lawmakers critical of Fannie Mae believe they have a strong chance to write as tough a regulatory regimen as they want.

"There's been a steady stream of troubling revelations about business practices" at Fannie Mae, said Andrew Gray, spokesman for Senate Banking Committee Chairman Richard C. Shelby (R-Ala.). "Senator Shelby believes that now more than ever it's time to act."

Gray said that establishing a new regulator for Fannie Mae was "the top priority for the committee" and that hearings on the proposal are likely to be held in February.

The chairman of the House Financial Services Committee also plans to push vigorously for a new Fannie Mae regulator. "We intend to hold hearings early next year," said Rep. Michael G. Oxley (R-Ohio).

Fannie Mae officials have said that they plan to cooperate closely with lawmakers to establish the new agency. Then again, no one is underestimating Fannie Mae's ability to wield influence on Capitol Hill. When it comes to Fannie Mae, Gray said, "nothing is ever easy."

—Jeffrey H. Birnbaum

Legal Options

Sarbanes-Oxley Act Could Punish Executives

Thanks to a two-year-old corporate responsibility law, regulators and directors have powerful new tools at their disposal if their investigations uncover misconduct at Fannie Mae.

Congress passed the Sarbanes-Oxley Act of 2002 after top executives at scandal-ridden companies, including Enron Corp. and WorldCom Inc., said they were unfamiliar with the details of company accounting practices that resulted in devastating losses by investors.

The law requires chief executives and financial officers to certify the accuracy of corporate financial statements.

Officials who "willfully" sign off on faulty financial reports knowing they are incorrect could be sentenced to 20 years in prison and fined $5 million.

Another provision of the law allows corporate boards of directors to seize the bonuses and stock profits of chief executives and finance chiefs whose companies restate financial results because of "misconduct."

If Justice Department and Securities and Exchange Commission investigations turn up evidence against chief executive Franklin D. Raines or Chief Financial Officer J. Timothy Howard, they could be subject to both measures, legal experts said.

Raines received a $4.2 million bonus and stock options valued at $3 million in 2003.

Howard received a $1.2 million bonus and options worth $2.35 million that year, according to SEC filings.

Last week the SEC's top accountant directed Fannie Mae to restate its financial statements from 2001 to 2004, which could erase 38 percent of the company's reported profit during that time.

A federal judge in Birmingham recently upheld the constitutionality of the executive certifications, rejecting an argument by HealthSouth Corp. founder Richard M. Scrushy that the law was so vaguely worded, it failed to put defendants on notice about how they might break the law.

Scrushy is scheduled to go on trial next month on securities fraud and other charges.

Legal experts said the bonus forfeiture language in the Sarbanes-Oxley Act raises questions about the definition of "misconduct" and whether it would make top executives responsible for the actions of subordinates.

—Carrie Johnson

Relocation

Problems Won't Affect Move, Developer Says

When Fannie Mae outgrew its offices on Wisconsin Avenue in Northwest, it decided to move many of its employees to southwest Washington.

Fannie Mae signed a letter of intent this year to move to Waterside Mall at M and Fourth streets SW. The decision was seen as a boost to efforts to revitalize the area.

Mitchell N. Schear's firm is lead developer.

The company's board of directors, concerned about the costs of fixing accounting problems, may put the project on hold, according to sources familiar with the situation.

Mitchell N. Schear, president of Charles E. Smith Commercial Realty, which is the lead developer on the Waterside project, said last week that he does not expect Fannie Mae's troubles to affect the Waterside deal.

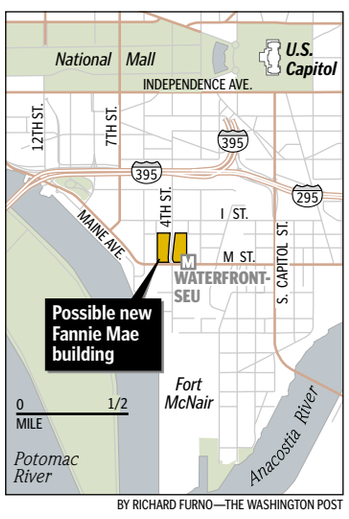
"The people that we work with at Fannie Mae have continued to work closely with us and press ahead," Schear said. He said he is "busy working through the negotiations" with Fannie Mae and hopes to have "something definitive" next year.

Alfred King, a spokesman for Fannie Mae, said the company would not comment on the real estate deal.

Fannie Mae chief executive Franklin D. Raines was a strong advocate of moving to Southwest. The new Fannie Mae site would also be close to Arena Stage, with which Raines and his wife are involved in a campaign to raise money to renovate the theater.

The $500 million Waterside project is planned to include 2 million square feet of offices—most of which Fannie Mae is expected to take—and 400 residential units. It would reopen Fourth Street SW and include 100,000 square feet of shops and restaurants, and underground parking. Charles E. Smith's development partners are Forest City Enterprises Inc. of Cleveland and Bresler & Reiner Inc. of Rockville.

—Dana Hedgpeth



BY RICHARD FURNO—THE WASHINGTON POST

The Regulator

Scandal Boosts Oversight Agency's Reputation

The Securities and Exchange Commission's order last week that Fannie Mae correct its financial statements helped restore the credibility of its federal regulator, the often-maligned Office of Federal Housing Enterprise Oversight.

Armando Falcon Jr. sought independence.

It was the regulator, with the aid of accounting firm Deloitte & Touche LLP, that said Fannie Mae violated accounting rules, a stand the SEC vindicated despite denials by the company. OFHEO's relationship with the companies it regulates has been rocky since the agency's creation more than a decade ago.

Fannie Mae executives for years have tried to chip away at OFHEO's credibility in Congress by making agency officials seem over their heads when it comes to complex accounting issues. And OFHEO officials were criticized in hearings last year, at which they were surprised by accounting problems at the other government-chartered housing finance company it regulates, McLean-based Freddie Mac.

Sen. Christopher S. Bond (R-Mo.), chairman of the Senate Appropriations Committee subcommittee with jurisdiction over OFHEO, has sought to cut a proposed budget increase that the regulators needed to fund an in-depth accounting review of Fannie Mae. Bond, whose office didn't return calls Friday seeking comment, asked the Housing and Urban Development Department's inspector general to investigate OFHEO for possible leaks of sensitive information about Fannie Mae.

OFHEO Director Armando Falcon Jr. has told Congress that the agency's oversight of Fannie Mae and its smaller rival Freddie Mac would benefit if it were taken out of HUD and, like other federal financial regulators, given more independence from yearly political battles over its budget, which must be approved by Congress—even though the money comes from Freddie Mac and Fannie Mae, not the government.

Each year, especially since the agency began its targeted review of Fannie Mae accounting, the District-based company has said in public that it supports a strong regulator while working behind the scenes to cut proposed budget increases for OFHEO, congressional aides said.

—Kathleen Day

Freddie Mac

Smaller Rival Showed Remorse, Cooperated

When Freddie Mac uncovered accounting problems last year, its attitude was much different from that of Fannie Mae, its larger housing finance competitor, when it ran into the same kind of trouble.

Freddie's problems were found by the company's own accountants, and its board of directors immediately began working with its regulator, the Office of Federal Housing Enterprise Oversight, to correct the damage. Fannie Mae's issues were discovered by OFHEO and the company came out swinging, deriding its critics and assuring the public that it was right and the government was wrong—until the Securities and Exchange Commission sided with the regulator.

Freddie Mac is widely perceived to have recovered. Though it is still rebuilding its accounting systems after correcting billions of dollars in mistakes, Freddie stock closed Friday at $10 a share higher than the day before its scandal broke. Its new chief executive, Richard F. Syron, is a model of the low-profile restraint that's coming back into fashion among chief executives.

Spokesmen for Fannie Mae and Freddie Mac declined to comment.

Don Goldberg, a managing director at Qorvis Communications LLC, a Washington firm that specializes in "crisis communications," said the difference between Freddie's and Fannie Mae's posture is "diametrically opposite" from a public relations standpoint.

"Freddie Mac expressed humility," said Goldberg, who worked on communications strategy in the Clinton White House. "Raines came off as very cold. He gave off an air of arrogance."

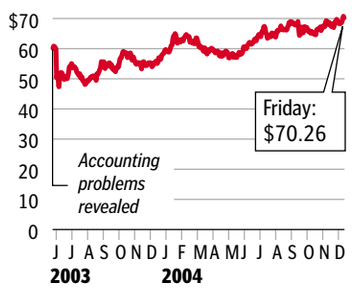
Raines's and Fannie Mae's posture was colored by the company's adversarial relationship with its regulator. Through the investigation, from document requests right up until the days following its damning report two months ago, Fannie Mae sought to cast the agency and its chairman, Armando Falcon Jr., as the bad guys.

In short, Fannie Mae painted itself into a corner by engaging in a high-risk fight with its regulator, said Jay Cochran III, research fellow in regulatory studies at the Mercatus Center at George Mason University. "The American public and policymakers have an unbelievable capacity to forgive you as long as you admit mistakes and show that you're doing something about it," Goldberg said. "Fannie hasn't admitted to any mistakes."

—Terence O'Hara

Bouncing Back

Freddie Mac stock price
Daily closes

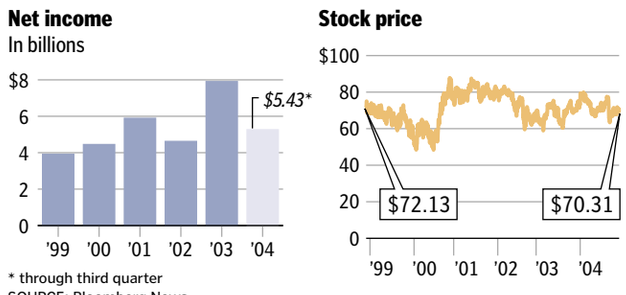


SOURCE: Bloomberg News

THE WASHINGTON POST

Fannie Mae Under Raines

The financial and stock performance of Fannie Mae since Franklin D. Raines became chief executive in 1999. Last week, the Securities and Exchange Commission told the company to correct its financial statements, which will reduce its earnings since 2001 by $9 billion.



* through third quarter
SOURCE: Bloomberg News

THE WASHINGTON POST

Raines Embraced A Celebrity Role

RAINES, *From E1*

vestigation, came to a starkly different conclusion in September, releasing a report that cited serious lapses in internal accounting controls, allegedly rigged earnings and willful flouting of accounting rules. Then last week, the Securities and Exchange Commission's chief accountant concurred in a stinging rebuke of Fannie's and Raines's public denials of financial logrolling. Fannie Mae's board met Thursday and yesterday as some investors and corporate governance specialists were calling for Raines's ouster. They have not announced a resolution.

Fannie's fall from grace, though it has to do with arcane accounting rules and the impenetrable columns of Fannie's balance sheet, is a deeply personal test for Raines.

"It's very painful for him," said a close friend and business associate, who spoke on condition of anonymity because Raines and the company have asked people close to the situation not to comment to the press. "He's a straight arrow."

Raines himself declined to comment.

Throughout his career, Raines has woven his life story into his public image.

He was born in Seattle, the fourth of six children, to a family that had moved to the city from the deep South in search of a steady paycheck. His father worked as a mechanic at Boeing, his mother as a cleaning lady in the aircraft maker's executive offices. His father suffered from depression and lost his job because of long absences. The family made ends meet with welfare checks. Raines went to work to bring in extra money when he was 8.

Raines excelled in school, becoming class president in high school and a champion debater. He graduated in 1967 with perfect grades and was awarded a scholarship to Harvard University. His cool-headed leadership during the student uprisings at the school in 1969 caught the eye of a professor there, Daniel Patrick Moynihan, the future New York senator. That summer, Moynihan invited Raines to intern in the Nixon White House, where Moynihan was a special assistant to the president.

From there, Raines's career took off: Rhodes Scholar, Harvard Law School, private law practice, domestic policy adviser in the Carter Administration. In 1980, he joined the investment bank Lazard, Freres & Co. in New York, and became general partner in 1985. He quit the job in 1991 to spend more time with his young children, who were living in Washington.

James A. Johnson, then Fannie's chief executive, asked Raines to become Fannie's vice chairman in 1991. The company's offices were a short drive from his home. In his first stint at Fannie, Raines worked mostly in the guts of the company, improving its technology and making its underwriting operations more efficient.

In 1996, President Clinton appointed Raines director of the Office of Management and Budget. He was instrumental in Clinton's budget battles with the Republican-controlled Congress, eventually winning bipartisan support for most of Clinton's spending priorities and laying the groundwork for a balanced budget by 2002.

Raines was not a political operator in the classic Washington sense, say those who worked with him in government. "Fairly distant, all business," said one Clinton staffer who had weekly contact with Raines.

"He's not a politico, he's not part of that world," Johnson told The Post in 1996.

Yet he was not without considerable political skill. Raines's job at OMB put him into close contact with many of the legislators from both parties who had a hand in overseeing Fannie Mae and Freddie Mac.

When Johnson decided to leave Fannie Mae in 1998, he personally lobbied his board to replace him with Raines, who became chief executive in January 1999. He was the first African American to hold the top job at a Fortune 500 company.

In his tenure, Raines's primary tasks have been managing the risks associated with the mortgage finance market, as well as political challenges to Fannie's government-sponsored status.

As a business, Fannie Mae has thrived under Raines. Its revenue grew an average of 11.5 percent a year from 1999 to 2003, its reported net income 22 percent, although the results for those years are likely to be restated. Stockholders during Raines's tenure have fared less well: Fannie's stock, at Friday's close of $70.31, trades slightly below its price on the day Raines took the top job. Fannie pays a regular dividend, but its shares are volatile for the stock of such a large company, trading as high as $87 a share in 2001 and as low as $46 in 2000.

Raines is among the highest-paid chief executives in the financial services sector. In 2003, he took in more than $16.8 million in cash compensation (salary, bonus and long-term incentive payouts), compared with $11.5 million in similar compensation in 2002 and $10.9 million in 2001. He has also received options to purchase more than 700,000 shares from 2001 to 2003.

Raines has managed Fannie's political risk vigorously, deploying campaign contributions, a potent force of lobbyists and allies among homeownership groups, and his personal charm in the service of protecting Fannie Mae's government-sponsored status, which lowers its borrowing costs relative to purely private companies and exempts it from most local taxation.

But it was Fannie's accounting, not its many critics, that has proven the enemy. When publicly confronting the accounting controversy, at an Oct. 6 hearing of the House Financial Services subcommittee overseeing Fannie Mae and Freddie Mac, Raines mustered all his talent to counter the allegations, carefully arguing that the accounting rules in question "are highly complex and require determinations over which experts often disagree."

But he began his testimony not with these arguments, but with himself. These charges, he seemed to be saying, were personal.

"My name is Frank Raines. I'm the son of Ida and Delno Raines. I grew up in Seattle, went to public school, graduated from college and law school. I'm a brother, a husband, a father and friend. . . . I introduce myself in this way not because I'm a stranger to this committee, but because I do not recognize the person, colleagues or company that someone described this morning."

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The Washington Post

WASHINGTON BUSINESS

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Stocks
Washtech

Monday, December 20, 2004

DEALMAKERS

Terence O'Hara

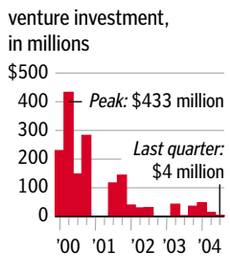
Tracking Signs Of a Rebound In Telecom

Investing in early-stage telecommunications companies in the past three years took a strong stomach. But a few local venture investors who have stuck with the sector are beginning to see signs that the indigestion may have been worth it.

It's nothing like 1999 and 2000, when telecommunications companies with no revenue and untested technology were at times valued in the billions of dollars. But after three years of dormancy, 2004 was the year that venture capital investing in telecommunications equipment, software and wireless gizmo firms became respectable again.

Troubled Industry

Metro area telecom sector venture investment, in millions



SOURCE: MoneyTree survey

"We feel very sanguine about our telecom portfolio," said **Tom Smith**, a partner at **Mid-Atlantic Venture Funds** of Reston. "All of our companies are meeting or exceeding their plans."

Sanguine may not rival "ecstatic," the word most often used in 2000 when early-stage telecoms were white hot, but Smith has a few reasons to be genuinely happy about his telecoms.

First, merger-and-acquisition activity is increasing. For example, large telecommunications equipment companies, squeezed by the drop in spending by the large phone companies in recent years, pulled back on expensive

See **DEALMAKERS**, *E3, Col. 1*

WASHINGTON INVESTING

Jerry Knight

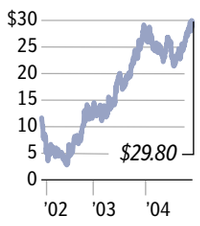
Nextel Stock Pays Off for Legg Mason Fund

The merger of Nextel and Sprint is producing handsome returns for Washington investors and Baltimore's best-known money manager.

Now approaching $30 a share, Nextel Communications Inc. stock could be bought for less than $3 in July 2002. Nextel shareholders are scheduled to get Sprint Corp. shares and a little cash for a total value of $32.50 a share if and when the merger is completed next year.

Rebound

Nextel stock price



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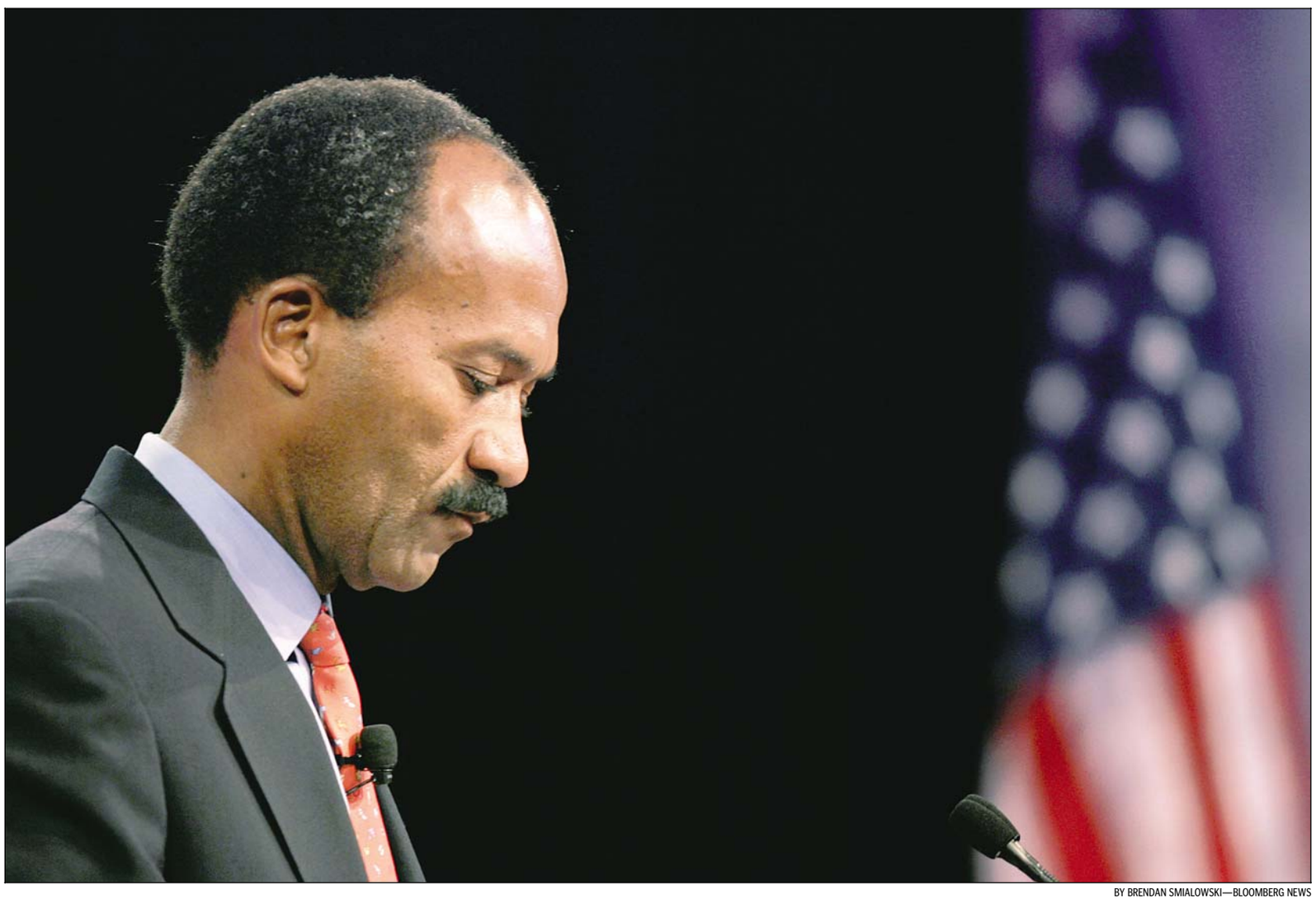

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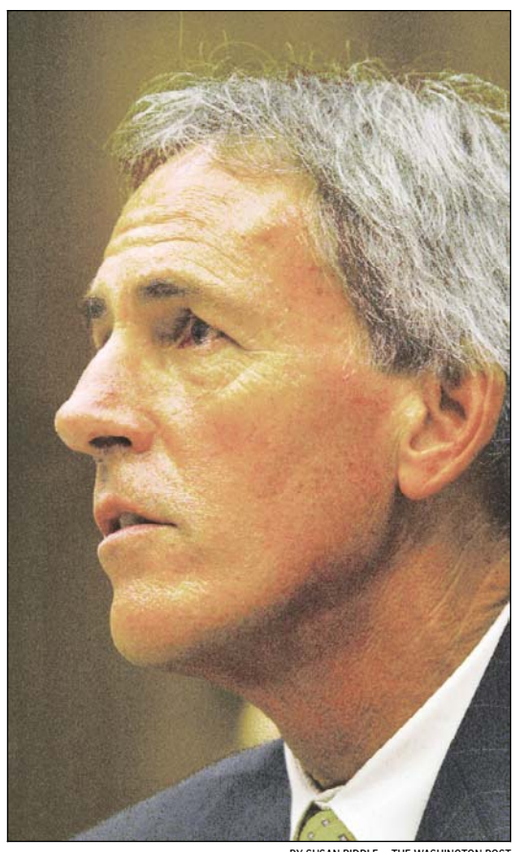

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FALLOUT AT FANNIE MAE | *Challenging Corporate Resolve*

Company Mobilized Bipartisan Defenders

COMMITTEE, *From E1*

As Raines went out on a limb to deny the allegations of accounting manipulations, Fannie's ability to mobilize political support in battle after battle over the past several years gave him reason to feel confident. Over the past year, for instance, Fannie's political action committee gave $121,000 in campaign contributions to members of the subcommittee.

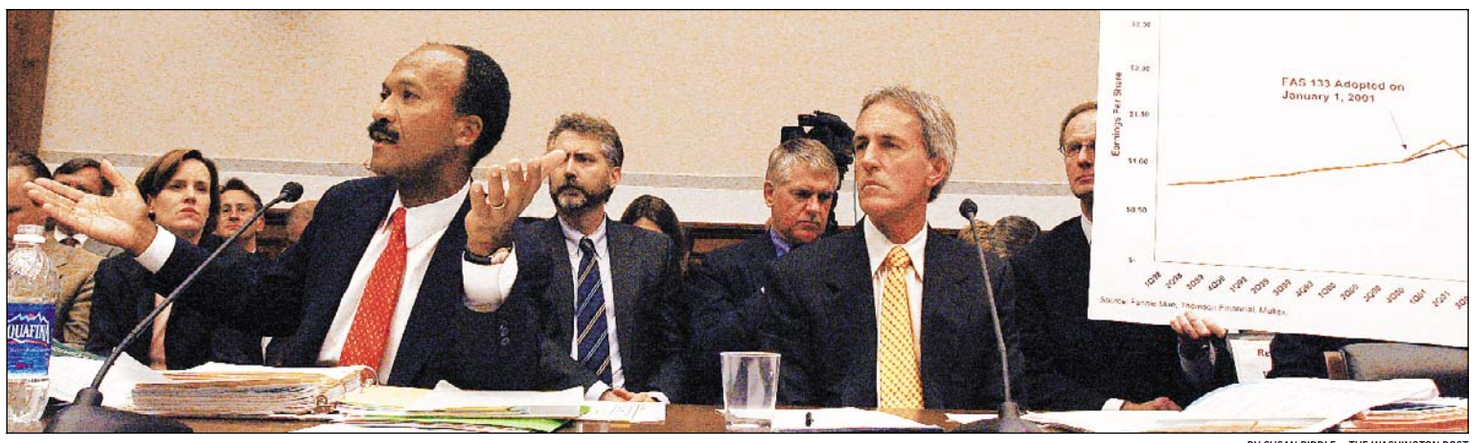
Looking up at the dais, Raines saw Rep. Spencer Bachus (R-Ala.), who had attended a boat ride brunch Fannie Mae hosted for Alabama lawmakers at the Republican convention. He saw Rep. Maxine Waters (D-Calif.), who had received a "Homeownership Hero" award from a housing industry alliance that Fannie helps sponsor. He saw Rep. Joseph Crowley (D-N.Y.), in whose district Fannie had helped provide mortgage assistance for union members.

And, behind the dais, Raines saw a portrait of former committee chairman Jim Leach (R-Iowa), for which Raines had led the private fundraising effort.

Not part of the hearing but part of the backdrop was Sen. Christopher S. Bond (R-Mo.), chairman of the Senate subcommittee that handles the budget of Fannie's regulator, the Office of Federal Housing Enterprise Oversight.

In the months before the hearing, Bond had advanced legislation to withhold $10 million of OFHEO's funding until its director was replaced and had asked the inspector general at the Department of Housing and Urban Development to investigate possible political bias in the way the agency was probing Fannie's accounting.

Raines, a Democrat and a resident of the District, had joined other Fannie Mae employees in contributing campaign money to the Missouri Republican. When the Fannie Mae Foundation donated $25,000 to the St. Louis chapter of the American Red Cross in 1993, the foundation issued a news release headlined, "SEN. BOND AND FANNIE MAE FOUNDATION PRESENT A GRANT FOR FLOOD VICTIMS IN ST. LOUIS."



BY SUSAN BIDDLE—THE WASHINGTON POST

Franklin D. Raines and J. Timothy Howard deny allegations of accounting manipulations at a House Financial Services Committee in October.

One of the few hostile politicians in the hearing room was Rep. Christopher Shays (R-Conn.), whose district is home to one of Fannie's biggest rivals, the manufacturing and financial services giant General Electric.

"I am tempted to ask how many people in this room are on the payroll of Fannie Mae, because what they do is they basically hire every lobbyist they can possibly hire—they hire some people to lobby and they hire some people not to lobby so that the opposition can't hire them," Shays said.

Rep. Richard H. Baker (R-La.), chairman of the House subcommittee that watches Fannie Mae, riled some of his colleagues by distributing a chart that showed the 2002 compensation of 22 top Fannie Mae executives, including executives with political and lobbying portfolios.

Among the names on the list were Arne Christensen, who had been a top aide to former House speaker Newt Gingrich (R-Ga.) and received compensation of $1,521,631 but had since left the company, and Duane Duncan, who had been a top aide to Baker and received compensation of $920,144.

Despite Duncan's presence on Fannie's lobbying squad, Baker has remained one of the company's toughest critics, and he opened the hearing by arguing that if Fannie foundered, taxpayers could shoulder the cost of a government bailout.

Clay cast the event in a different light.

"This hearing is about the political lynching of Franklin Raines," Clay said in an opening statement, before the questioning of the witnesses had begun.

One week earlier, Fannie Mae had issued a news release announcing that Clay joined the company in celebrating Fannie's investment of more than $50 million in a downtown St. Louis housing project. Before the month was out, Fannie had issued another news release on an initiative to make it easier for St. Louis, Mo., residents to buy homes near public transportation. That release noted Clay's participation in an event announcing the initiative.

As one of the most prominent African Americans in corporate America and a senior member of the Clinton administration, Raines had an affinity with the overwhelmingly Democratic Congressional Black Caucus that transcended local politics. At a ceremonial swearing in for members of the caucus in 2001, Raines delivered a speech on the history of African Americans in Congress—and drew at length from a book by Clay's father, who preceded him in the House.

After the hearing, Clay backpedaled from his "lynching" comment.

"That was the emotion, in words, that the proceedings provoked," Clay, who is African American, said in a written statement. "The fact that Mr. Raines is a black man is not the whole of the story."

Waters, another member of the Black Caucus, is not a member of the subcommittee that held the hearing, but she attended and asked OFHEO director Armando Falcon Jr. whether he had gotten advice from House members such as Baker on how to investigate Fannie Mae. With the presidential election weeks away and Raines mentioned as a possible appointee in a Democratic administration, she also asked Raines how the accounting controversy might affect his prospects.

Crowley, chief deputy whip for House Democrats, used some of his time at the hearing to echo a main theme of Raines's defense.

Addressing the OFHEO director, Crowley said, "[I]t is the SEC, I believe, and not OFHEO, who has the final say over whether or not Fannie Mae must restate past earnings. Is that correct?"

When the regulator agreed, Crowley added: "Some have argued to me that there's more than an even chance the SEC may disagree with some of the most damaging allegations."

Raines told the subcommittee that he wished OFHEO had taken its allegations about Fannie Mae's accounting to the SEC for resolution before issuing its report criticizing the company.

"Then we will have the answer," Raines said. "We won't be having a debate about who is right and who is wrong."

Last week, the SEC's top accountant ended the debate.

(Staff researcher Madonna Lebling contributed to this story.)

Reassuring Answers

After the disclosure of accounting problems at Freddie Mac last June, Fannie Mae chief executive Franklin D. Raines defended the company's practices in statements and answers to interviewers' questions.

Accurate Accounting: Should investors have confidence that they have your personal assurances?

"Well, they've got it in writing. That's one of the things that's happened now since the Sarbanes-Oxley Act that CFOs and CEOs have to personally certify to their financial statements. And so we go to a great effort to every quarter, to satisfy ourselves that we have in place the kinds of internal controls necessary to make that kind of certification."
CNNFN interview, July 15, 2003

Accounting Rules: Has Fannie Mae circumvented them?

"The answer to that is clearly, no. We have not. If we had, I would have violated the law in certifying our financial results. If we had, our auditors would be obligated to publicly do something about that."
News conference, July 30, 2003

Impact of Investigations on Fannie Mae and Freddie Mac

"I think it has been devastating to the reputation of these firms, and I think it has caused material harm to consumers, because we have seen the uncertainty injected into the capital markets, and that uncertainty takes the form of higher interest cost."
News conference, July 30, 2003

Fallout from Freddie Mac's Problems

"And we have suffered a lot of that, and I think unfairly, because as I mentioned before, unlike Freddie Mac, we didn't do any of these things. We should not be subject to the same penalty that they are being subjected to."
News conference, July 30, 2003

Regulatory Scrutiny

"We welcome the review by OFHEO, because we have a great deal of confidence in our application of appropriate accounting principles."
News conference, July 30, 2003

Fannie Mae's Hedging Techniques

"We don't use any exotic derivatives, just the plain vanilla options and interest-rate swaps to achieve our goals."
Interview with America's Community Banker, Oct. 1, 2003

Corporate Governance

"We work very hard at Fannie Mae to be a best-in-class company with regard to corporate governance and disclosures, and Fannie Mae and Freddie Mac are apparently quite different companies in that regard."
Speech at George Washington University, Dec. 18, 2003

RESEARCH BY RICHARD DREZEN—THE WASHINGTON POST

Fannie Mae's Directors

The company's board includes a host of well-known members with backgrounds in business and academia.

MANAGEMENT

Franklin D. Raines, chairman of the board and chief executive
Daniel H. Mudd, vice chairman and chief operating officer
J. Timothy Howard, vice chairman and chief financial officer

NONMANAGEMENT

Stephen B. Ashley — *Board member since* 1995
Chairman and chief executive, Ashley Group, a group of commercial and multifamily real estate companies based in Rochester, N.Y.

Kenneth M. Duberstein — *1998*
Chairman and chief executive, Duberstein Group Inc., a strategic planning and consulting company in the District.

Thomas P. Gerrity — *1991*
Professor of Management, Wharton School, the University of Pennsylvania's business school in Philadelphia.

Ann Korologos — *1994*
Vice Chairman, RAND Corp. Board of Trustees, a nonprofit research organization based in Santa Monica, Calif.

Frederic V. Malek — *2002*
Chairman, Thayer Capital Partners, a District-based private equity investment firm.

Donald B. Marron — *2001*
Chairman and chief executive, Lightyear Capital, a private equity investment firm in New York.

Joe K. Pickett — *1996*
Former chairman and chief executive, HomeSide International Inc., a mortgage banking company in Jacksonville, Fla.

Leslie Rahl — *2004*
President and founder, Capital Market Risk Advisors Inc., a financial advisory firm in New York.

H. Patrick Swygert — *2000*
President, Howard University

John K. Wulff — *2004*
Chairman of the board, Hercules Inc., a manufacturing company based in Wilmington, Del.

SOURCE: company reports

THE WASHINGTON POST

Chief Financial Officer Resisted Accounting Board's Standards

HOWARD, *From E1*

as high-profile as Fannie Mae's chief executive, Franklin D. Raines, but wielded great behind-the-scenes power. A September report from the Office of Federal Housing Enterprise Oversight said Howard's wide influence led to conflicts of interest as he both set financial goals and then oversaw the accounting of whether those goals were met.

In December 2000, the accounting board was about to put into effect the rule that now has Fannie Mae in trouble with the Securities and Exchange Commission—a regulation called FAS 133 that governs how companies account for financial instruments called derivatives. "We have been preparing for the advent of FAS 133 for the past three years," Howard told investment analysts in a conference call at the time. "We've been in a continual substantive dialogue with the FASB on the workings of FAS 133, and we now are widely viewed as a leading source of expertise on its implementation."

But after FAS 133 took effect, Howard continued to write letters to the chairman of the accounting board complaining that the regulation was onerous. It forced Fannie Mae to show paper liabilities that would never be realized, he wrote in January 2002, and "represents a deadweight economic cost to our investors."

Citing a giant corporate scandal in the news at the time, Howard assured the FASB chairman that "Fannie Mae is almost the polar opposite of Enron. We strive for the utmost clarity in our financial reports."

A Special Status Examined

Economists Differ on Value of Government Charters

By Terence O'Hara
Washington Post Staff Writer

Their advertising focuses on the "American dream" of homeownership. They stand behind nearly half of the home mortgages in the country, making Fannie Mae and Freddie Mac, by asset size, the second- and third-largest companies in the nation, after Citigroup.

Yet long before the accounting problems that rocked Freddie Mac last year and Fannie Mae recently, there's been a growing call in Washington to rein in the housing finance giants and cut their ties to the government.

"We don't need them," said Peter J. Wallison, an economist and resident fellow at the American Enterprise Institute. "They produce very little of any value to the housing market."

Wallison's view is widely shared in the private-sector secondary mortgage market, where competitors chafe at Fannie Mae's and Freddie Mac's government-sponsored benefits. But even with the problems at the two companies, Congress is not expected to change Fannie Mae's and Freddie Mac's structure or charters, experts and lawmakers said last week.

That's because both companies, with their vast size and peculiar status, have put down deep roots in the financial system. Tinkering with their business could cause unintended consequences, said Jay Cochran III, a research fellow in regulatory studies at the Mercatus Center at George Mason University.

"One would hope that we could have real change," he said. "But that remains to be seen. It's really a political question."

Spokesmen for the two companies declined to comment, but in the past the firms have staunchly defended their blend of government charter and private enterprise, claiming that it reduces borrowing costs for homeowners and assures ready cash for home lenders.

The companies ply their business in a number of ways.

First, they buy mortgages from banks, savings and loans, and other mortgage lenders, freeing those lenders' cash to make more loans. Fannie Mae and Freddie Mac pay for those mortgage purchases by selling bonds in the public markets. They also guarantee mortgage-backed securities, investments sold on the open market that are backed by pools of thousands of home mortgages. The system is known as the secondary mortgage market.

Both before and after Fannie Mae and Freddie Mac became private companies, the system helped make credit widely available.

It also made Fannie Mae and Freddie Mac gigantic and made their stockholders and executives wealthy. The firms have a combined market value of more than $100 billion, roughly four times their worth 10 years ago. At the end of 2003, Freddie Mac had more than $1 trillion in assets and Freddie Mac had more than $800 billion, made up mostly of mortgage loans, each other's bonds, mixed securities and cash.

Because they were chartered by Congress, both companies have the implied, if not legally binding, backing of the government. That allows them to sell bonds at lower interest rates in the open market because investors perceive them as safer.

Finally, Fannie Mae and Freddie Mac securities—their bonds and mortgage-backed securities—are one of the basic tools of financial-institution spreadsheets in the United States and abroad. U.S. banks buy billions of dollars worth of them a year. Further, because of the perceived safety, federally insured financial institutions can hold high concentrations of the government-sponsored-enterprise securities, well above that allowed of other securities.

Those many tentacles into the financial system are the main reason why some—most prominently Federal Reserve Chairman Alan Greenspan—have expressed concern about "systemic risk." That is, under their current structures, if Fannie Mae or Freddie Mac falter, the shock to the system could be too great, and the financial risk to the government too heavy, to bear.

"My personal belief is that Congress has put an apple before the management of Fannie Mae. It's understandable that they bit," said Rep. Jim Leach (R-Iowa), who as chairman of the House Banking Committee in the 1990s often criticized aspects of Fannie Mae and Freddie Mac.

Leach said he was troubled by the accounting problems because he had always considered the companies well managed. "When you privatize profit and socialize risk, it's a prescription for lack of discipline," he said.

If Fannie Mae and Freddie Mac's government status were removed, what would happen?

Very little, Wallison said. The secondary market for loans that Fannie Mae and Freddie Mac don't buy "works perfectly well." Private-sector financial institutions, able to compete on the same terms for capital, would probably rush to fill the gap, he said.

Whatever benefits Fannie Mae and Freddie Mac passes on to homeowners in the form of slightly lower rates—the most liberal estimate is about a quarter of a percentage point off an interest rate—would be compensated for by more competition, Wallison said.

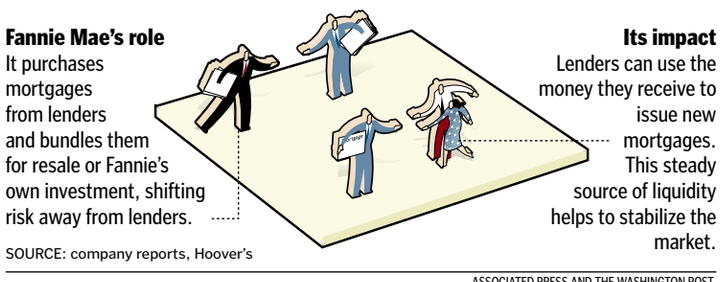
"If we did not have Fannie Mae and Freddie Mac, we would have a very vigorous, large secondary mortgage market today," he said. The American Enterprise Institute has long argued for less government involvement in private enterprise.

Other observers said the social benefits of keeping Fannie Mae and Freddie Mac close to the federal government outweigh the risks—as long as each is regulated properly.

"An argument against privatizing them is there's always going to be some political interest in having an entity like Fannie Mae and Freddie Mac," said James E. Pearce, an economist at Welch Consulting in College Station, Tex. Pearce co-authored a 2001 study, partially funded by Freddie Mac, about the benefits of the company's government charters. "Taking them out of the government sphere of influence entirely . . . would make them look more like GE Capital or like some other large financial institution. They would not have the social responsibilities they have now, and would not be an outlet for members of Congress and the executive branch to influence the flow of credit in particular ways. If they did away with them, they would have to come up with something else to take their place."

Impact on the Mortgage Market

Fannie Mae is the Washington area's largest company and the nation's leading source of home mortgages, involved in about one out of every five mortgages.



SOURCE: company reports, Hoover's

ASSOCIATED PRESS AND THE WASHINGTON POST

DAILY 12-22-04 MD M2 A1 CMYK

Weather

Today: *Partly sunny. High 53. Low 45.*
Thursday: *Windy, rain. High 56. Low 38.*

Details, Page **B10**

The Washington Post

128TH YEAR NO. 17 M2 DC MD VA

WEDNESDAY, DECEMBER 22, 2004

M1 M2 M3 M4 V1 V2 V3 V4

FINAL

Inside: **Food, Classified**
Today's Contents on Page A2

35¢

Prices may vary in areas outside metropolitan Washington. (See box on Page A4)

Mess Tent Blast Kills 15 GIs

BY DEAN HOFFMEYER—RICHMOND TIMES-DISPATCH VIA ASSOCIATED PRESS

U.S. soldiers and others tend to the wounded after the noon attack. The blast, at first attributed to a mortar or rocket, was under investigation.

60 Hurt in Mosul; Attack Is Deadliest On a U.S. Base

By KARL VICK
Washington Post Foreign Service

BAGHDAD, Dec. 22—An explosion tore through a crowded U.S. military mess tent in the northern Iraqi city of Mosul on Tuesday, killing at least 22 people and wounding about 60. Fifteen of the dead were U.S. soldiers, and most of the casualties were Americans who had just sat down to lunch.

It was the deadliest attack on a U.S. military installation in the 21 months since the war in Iraq began.

The explosion, which came at noon, was at first believed to be caused by a mortar round or rocket that pierced the white canvas tent that serves as mess hall at Forward Operating Base Marez, near the Mosul airport.

But in an online assertion of responsibility for the attack, a radical Muslim group described "a suicide operation." Military officials said the cause of the blast was under investigation, and some security experts said the extent of injuries indicated that it was possible a bomb had been planted inside the hall.

First Sgt. Steve Valley, a U.S. military spokesman in Baghdad, said early Wednesday that in addition to the American troops, the fatalities included five U.S. contractors and two members of the Iraqi security forces. Officials initially said 19 American service members had been killed.

Two soldiers attached to the Richmond-based 276th Engineer Battalion, a Virginia National Guard unit, were among the dead, according to a Richmond Times-Dispatch reporter who was embedded with the troops.

President Bush, who was visiting families of wounded service members at Walter Reed Army Medical Center in Washington, said: "We send our heartfelt condolences to the loved ones who suffered today. We just want them to know that the mission is a vital mission for peace."

Halliburton Co., a Houston-based firm whose subsidiary Kellogg Brown & Root supplies food service and other support activities for U.S. troops in Mosul, said some of its employees and subcontractors were killed in the blast, Bloomberg News Service reported. Their

See **IRAQ**, *A22, Col. 4*

Analysis

Precision of Base Attack Worries Military Experts

By THOMAS E. RICKS
Washington Post Staff Writer

In April 2003, as the U.S.-led invasion of Iraq was ending, the Pentagon projected in a formal planning effort that the U.S. military occupation of the country would end this month.

Instead, December 2004 brought one of the deadliest single incidents of the war for U.S. forces. More than 80 casualties were suffered yesterday by U.S. troops, civilian contractors and Iraqi soldiers when a U.S. base near the northern Iraqi city of Mosul was blasted at lunchtime.

Defense officials said 15 of those killed in the attack on a mess tent at the city's airport were American soldiers—more U.S. troops than have been lost in nearly any other major incident in the fighting, even during the spring 2003 invasion. Before yesterday, the worst incidents were the deaths of 17 soldiers from the 101st Airborne Division in the November 2003 collision of two UH-60 Black Hawk helicopters, also in Mosul, and, two weeks before that, the loss of 15 soldiers when a CH-47 Chinook transport helicopter crashed west of Baghdad. All three occurred after President Bush's May 2003 declaration that major combat operations in Iraq had ended.

The major difference between the latest attack and the earlier incidents is that it was an attack on a U.S. base, rather than on troops in transit in vulnerable aircraft. That difference appears to reflect both the persistence of the insurgency and its growing sophistication, as experts noted that it seemed to be based on precise intelligence. Most disturbingly, some

See **ANALYSIS**, *A20, Col. 1*

BY DEAN HOFFMEYER—RICHMOND TIMES-DISPATCH VIA ASSOCIATED PRESS

Cpl. Nathan Almquist, standing next to a stretcher holding the body of a victim of the attack, is hugged by a fellow soldier.

Amended Deal on Stadium Approved

Council Seals Return Of Baseball to D.C.

By DAVID NAKAMURA *and* THOMAS HEATH
Washington Post Staff Writers

The Washington Nationals secured a home yesterday when a divided D.C. Council narrowly approved legislation that allows baseball to return to the nation's capital after 33 years.

With a vote of 7 to 6, the council adopted a stadium package that contains several amendments to the original deal Mayor Anthony A. Williams struck with Major League Baseball in September. After three seasons at Robert F. Kennedy Memorial Stadium, beginning in April, the former Montreal Expos are scheduled to move to a new ballpark along the Anacostia waterfront in 2008.

The council's action came a day after a marathon negotiating session between Williams (D), council Chairman Linda W. Cropp (D) and baseball officials, who found a middle ground between cost savings measures the council added last week and stadium funding guarantees sought by baseball officials.

The move punctuated weeks of debate among residents of Washington and its suburbs about the use of public financing to pay for a ballpark and officially returned baseball to the District for the first time since the

See **BASEBALL**, *A7, Col. 1*

Savings and Uncertainty

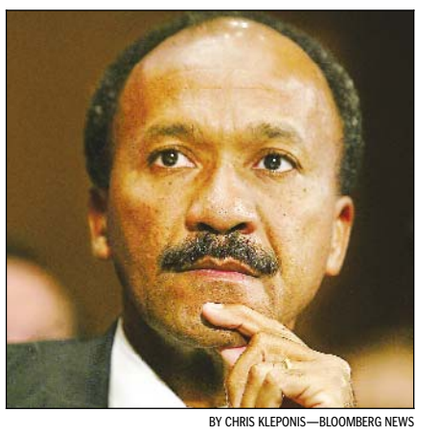
D.C. will benefit from changes, but how much is unclear.

METRO, *Page B1*

Open for Business

The Nationals can now start addressing other issues.

SPORTS, *Page D1*



BY CHRIS KLEPONIS—BLOOMBERG NEWS

"By my early retirement, I have held myself accountable," CEO Franklin D. Raines said.

Fannie Mae's Top Executives Leaving Firm

Raines, Howard Out Under Pressure

By DAVID S. HILZENRATH
Washington Post Staff Writer

Franklin D. Raines stepped down yesterday as chairman and chief executive of Fannie Mae, as the company's directors ended days of tense and emotional deliberations and bowed to pressure from regulators who wanted him out.

J. Timothy Howard, the company's longtime chief financial officer, also is leaving. Raines's departure was structured as an early retirement. Howard resigned.

The departures come less than a week after the Securities and Exchange Commission directed the giant mortgage-funding company to make accounting corrections that could erase $9 billion of past profit.

The District-based housing finance company, which stands behind or owns a quarter of the nation's mortgages, faces a criminal investigation by the Justice Department; a civil investigation by the Securities and Exchange Commission; an ongoing probe of other accounting issues by its main regulator, the Office of Federal Housing Enterprise Oversight; and class-action lawsuits by investors. In addition, Fannie's board has hired outside lawyers to investigate the regulators' allegations.

The government-sponsored company has been on the defensive since September,

See **FANNIE**, *A13, Col. 1*

New Papers Suggest Detainee Abuse Was Widespread

By R. JEFFREY SMITH *and* DAN EGGEN
Washington Post Staff Writers

The Bush administration is facing a wave of new allegations that the abuse of foreign detainees in U.S. military custody was more widespread, varied and grave in the past three years than the Defense Department has long maintained.

New documents released yesterday detail a series of probes by Army criminal investigators into multiple cases of threatened executions of Iraqi detainees by U.S. soldiers, as well as of thefts of currency and other private property, physical assaults, and deadly shootings of detainees at detention camps in Iraq.

In many of the newly disclosed cases, Army commanders chose noncriminal punishments for those involved in the abuse, or the investigations were so flawed that prosecutions could not go forward, the documents show. Human rights groups said yesterday that, as a result, the penalties imposed were too light to suit the offenses.

The complaints arose from several thousand new pages of internal reports, investigations and e-mails from different agencies, which, with other documents released in the past two weeks, paint a finer-grained picture of military abuse and criminal behavior at prisons in Cuba, Iraq and Afghanistan than previously available.

The documents disclosed by a coalition of groups that had sued the government to obtain them make it clear that both regular and Special Forces soldiers took part in the abuse, and that the misconduct included shocking detainees with electric guns, shackling them without food and water, and wrapping a detainee in an Israeli flag.

The variety of the abuse and the fact that

See **DETAINEES**, *A18, Col. 1*

Long Homeland Visits Can Trip Up Students

Schools Warn Immigrant Families

By TARA BAHRAMPOUR
Washington Post Staff Writer

Classrooms at Arlington's Wakefield High School had a few more empty seats than usual this week—not because of the nasty chest cold going around or a sudden rise in delinquency, but because at least 22 students have left the country for vacations that will last significantly longer than the school's 10-day winter break.

School officials expect that number to rise at Wakefield and other Washington area schools, as large numbers of students from immigrant families return to their native countries at the holidays. The trend has caused something of a conundrum for teachers trying to keep students on schedule, as well as for students concerned about their performance.

Parents say the trips are an important way for children to reconnect with their roots and are only worth the consider-

BY JUANA ARIAS—THE WASHINGTON POST

Monica Day, left, with mother Socorro Rojas, will miss a week of classes because of a family trip.

See **VACATION**, *A8, Col. 1*

INSIDE

Drug Importation

Two government reports raise cost and safety questions about a possible program for drug imports.

NATION, *Page A25*

Post Buys Slate

The Washington Post Co. has announced it will buy the online magazine Slate from Microsoft Corp. for an undisclosed amount.

STYLE, *Page C1*

Putin Defends Sale

President Vladimir Putin said the auction of major Yukos oil fields was legal and an internal Russian matter.

WORLD, *Page A15*

The Post on the Internet:
washingtonpost.com

Details Cloud Support For Social Security Plan

By JOHN F. HARRIS *and* DANA MILBANK
Washington Post Staff Writers

President Bush has wide support for his argument that Social Security needs dramatic change to meet its obligations to future retirees, but there remains considerable skepticism about his plan to let people invest a portion of their contribution to the program in the stock market, according to a Washington Post-ABC News poll.

Since his Nov. 2 reelection victory, Bush has frequently said the results were an endorsement by voters of the most dramatic revision of the retirement program since its inception nearly 70 years ago. But the survey shows that his efforts to educate the public about the idea and convince them of the merits are at best incomplete.

A strong majority of respondents, 63 percent, do not think Social Security will have enough money to pay the benefits they are entitled to, and 74 percent think the system faces either major problems or is in crisis—as Bush has asserted. The president also has at least general support from 53 percent of the public for the concept of letting people control some of their contributions to invest in the market.

See **POLL**, *A14, Col. 1*

Q: Would you support or oppose a plan in which people who chose could invest some of their Social Security contributions in the stock market?

	SUPPORT	OPPOSE
Dec. 19	53%	44%

NO OPINION 3%

Q: People in a plan like this would get higher Social Security benefits if the stock market went up but lower Social Security benefits if the stock market went down. Knowing that, would you personally put some of your Social Security money in the stock market or not?

	YES	NO
Dec. 19	37%	62%

NO OPINION 1%

THE WASHINGTON POST

Raines Retires, Howard Resigns at Fannie

FANNIE, *From A1*

when OFHEO alleged that Fannie had systematically manipulated accounting estimates, ignored accounting requirements it had lobbied unsuccessfully against and operated with weak internal controls that helped obscure the other problems. The report said Fannie Mae delayed booking $200 million of expenses in 1998, which allowed Raines and other top executives to receive millions of dollars in bonuses linked to Fannie's profit.

A source with knowledge of the board's recent deliberations described a sometimes painful debate. Raines, the source said, at times argued passionately that he had done nothing wrong.

Raines, 55, is one of the most prominent African Americans in corporate America. He rose from a family that supplemented work with welfare to become a Rhodes scholar, president of the Harvard University Board of Overseers, director of the Office of Management and Budget under President Bill Clinton and a leader of the Washington business community. His compensation last year, including $3 million in stock options, totaled about $20 million.

Fannie's federal regulator, however, demanded management changes, holding Raines responsible for a corporate culture that emphasized stable earnings at the expense of accurate financial disclosures. Sources said the regulator was determined to initiate a public proceeding to remove Raines if the board did not act.

The costs of an all-out fight with a federal regulator would be too great, Fannie's board ultimately concluded, so Raines was told he would have to go.

The board had decided by Monday evening to accept Howard's resignation. But its announcement was held up as directors continued to discuss different scenarios in which Raines would remain chief executive, including the appointment of an independent chairman.

In a statement, Raines said: "I previously stated that I would hold myself accountable if the SEC determined that significant mistakes were made in the Company's accounting. Although, to my knowledge, the Company has always made good faith efforts to get its accounting right, the SEC has determined that mistakes were made. By my early retirement, I have held myself accountable."

Ann McLaughlin Korologos, the presiding non-management director, thanked Raines and Howard for their "many contributions" and said the board "takes these steps today to move the company forward." The company also announced that the board's audit committee has dismissed KPMG LLP, the outside accounting firm that audited the financial statements Fannie will now correct.

Armando Falcon Jr., head of OFHEO, commended the board's action and said, "We are encouraged that the Board's announcement signals a new culture and a new direction for Fannie Mae."

OFHEO must still officially review the terms of departure for Raines and Howard. The agency last night declared Fannie Mae "significantly undercapitalized," a determination that gives the regulator additional powers over the company.

The 10-year-old agency has been testing its powers since the accounting scandal last year at its smaller rival, McLean-based Freddie Mac, when that company tried to let longtime chief executive Leland C. Brendsel retire with more than $50 million in compensation.

The regulator challenged that decision and has been in a court fight with Brendsel. A federal judge ruled in August that the agency was "simply overreaching" when it ordered most of Brendsel's payments withheld.

Fannie Mae announced several other changes. Board member Stephen B. Ashley, a former president of the Mortgage Bankers Association of America, will become nonexecutive chairman. Daniel H. Mudd, the company's vice chairman and chief operating officer, will serve as interim chief executive. And Robert J. Levin, executive vice president, will serve as interim chief financial officer while the company seeks permanent replacements.

Though it was not apparent at the time, Raines's downfall began in early 2003, when Freddie Mac disclosed that it had made billions of dollars in accounting errors. Ensuing investigations revealed that Freddie Mac executives had gone to elaborate lengths to make its earnings growth appear smooth.

Given the similar nature of the two companies, OFHEO decided to take a closer look at Fannie Mae's accounting. As that review got underway, Raines complained that Fannie was being unfairly tainted by its competitor's troubles, and he denied that Fannie had similar problems.

In its September report, OFHEO alleged that since a key accounting rule took effect in 2001, Fannie improperly excluded from earnings changes in the value of derivatives, complex financial instruments that can be used to speculate for profit or hedge against risk. Freddie Mac violated the same rule.

Howard, 56, who joined Fannie Mae in 1982 and had served as chief financial officer since 1990, oversaw Fannie's accounting.

At a congressional hearing in October, Raines pointed to the SEC as the authority on accounting matters and pinned his hopes on a favorable decision from the agency. Last week, the SEC's top accountant sided with OFHEO on questions of accounting policy, saying that instead of following the requirements, "Fannie Mae internally developed its own unique methodology."

On Capitol Hill, the scandal at Fannie Mae has reinvigorated efforts to create a more powerful regulator for Fannie and Freddie. Members of Congress and the Bush administration generally agree that the companies' primary regulator, OFHEO, is ill-equipped to oversee huge, complex institutions that could send shock waves through the economy and financial system if they ever foundered.

Fannie Mae, for example, has debts to bondholders of $957 billion, equal to about a fifth of the publicly held portion of the U.S. national debt. In addition, the company guarantees principal and interest payments on $1.9 trillion of mortgage-backed securities.

Raines's successor must add billions of dollars to Fannie's reserves, which will be below the company's regulatory minimum when it records the additional losses.

Established in the 1930s as the nation was emerging from the Great Depression, Fannie borrows money by issuing bonds and uses that money to buy mortgages from lenders, thereby giving the lenders cash to issue more loans. Fannie also packages mortgages into securities, attaching the company's guarantee that it will pay investors the principal and interest on the loans if the borrowers default.

Some corporate governance specialists were stunned by allegations that Fannie engaged in accounting manipulations years after the watershed scandals at Enron Corp. and WorldCom Inc. Those debacles inspired tough new legal penalties for accounting manipulations, served a warning to corporate bosses and seemed to bring about a change in the culture of America's boardrooms.

In the aftermath of Enron's collapse, Raines became a spokesman for the cause of good corporate governance. On behalf of the Business Roundtable, a group of chief executives of many of the nation's largest corporations, Raines led a task force that prescribed best practices for corporate leaders, and he publicly criticized executives who disclaimed responsibility for wrongdoing within their organizations.

Raines and Fannie Mae "have been so arrogant, not just to shareholders but so arrogant in Washington, that it's kind of a well-deserved comeuppance," said Sarah Teslik, former head of the Council of Institutional Investors.

But Arne Christenson, a former Fannie Mae executive who was before that a top aide to then-Speaker of the House Newt Gingrich, said Raines will be difficult to replace. "The thing about Frank is, he had a blend of business acumen and political savvy that was uniquely helpful to Fannie Mae," Christensen said.

"I'm sure he [Raines] would have preferred to have stayed, but things are the way they are," said attorney R. Timothy Columbus, a friend of Raines. "He did what he had to do."

Staff writers Jeffrey Birnbaum, Kathleen Day and Terence O'Hara contributed to this report.

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