

**THE SECURITIES AND EXCHANGE COMMISSION'S
\$500 MILLION FLEECING OF AMERICA: PART TWO**

(112-43)

HEARING
BEFORE THE
SUBCOMMITTEE ON
ECONOMIC DEVELOPMENT, PUBLIC BUILDINGS, AND
EMERGENCY MANAGEMENT
OF THE
COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE
HOUSE OF REPRESENTATIVES
ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

JULY 6, 2011

Printed for the use of the
Committee on Transportation and Infrastructure



Available online at: <http://www.gpo.gov/fdsys/browse/committee.action?chamber=house&committee=transportation>

U.S. GOVERNMENT PRINTING OFFICE

67-285 PDF

WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

JOHN L. MICA, Florida, *Chairman*

DON YOUNG, Alaska	NICK J. RAHALL II, West Virginia
THOMAS E. PETRI, Wisconsin	PETER A. DeFAZIO, Oregon
HOWARD COBLE, North Carolina	JERRY F. COSTELLO, Illinois
JOHN J. DUNCAN, JR., Tennessee	ELEANOR HOLMES NORTON, District of Columbia
FRANK A. LoBIONDO, New Jersey	JERROLD NADLER, New York
GARY G. MILLER, California	CORRINE BROWN, Florida
TIMOTHY V. JOHNSON, Illinois	BOB FILNER, California
SAM GRAVES, Missouri	EDDIE BERNICE JOHNSON, Texas
BILL SHUSTER, Pennsylvania	ELIJAH E. CUMMINGS, Maryland
SHELLEY MOORE CAPITO, West Virginia	LEONARD L. BOSWELL, Iowa
JEAN SCHMIDT, Ohio	TIM HOLDEN, Pennsylvania
CANDICE S. MILLER, Michigan	RICK LARSEN, Washington
DUNCAN HUNTER, California	MICHAEL E. CAPUANO, Massachusetts
ANDY HARRIS, Maryland	TIMOTHY H. BISHOP, New York
ERIC A. "RICK" CRAWFORD, Arkansas	MICHAEL H. MICHAUD, Maine
JAIME HERRERA BEUTLER, Washington	RUSS CARNAHAN, Missouri
FRANK C. GUINTA, New Hampshire	GRACE F. NAPOLITANO, California
RANDY HULTGREN, Illinois	DANIEL LIPINSKI, Illinois
LOU BARLETTA, Pennsylvania	MAZIE K. HIRONO, Hawaii
CHIP CRAVAACK, Minnesota	JASON ALTMIRE, Pennsylvania
BLAKE FARENTHOLD, Texas	TIMOTHY J. WALZ, Minnesota
LARRY BUCSHON, Indiana	HEATH SHULER, North Carolina
BILLY LONG, Missouri	STEVE COHEN, Tennessee
BOB GIBBS, Ohio	LAURA RICHARDSON, California
PATRICK MEEHAN, Pennsylvania	ALBIO SIRES, New Jersey
RICHARD L. HANNA, New York	DONNA F. EDWARDS, Maryland
JEFFREY M. LANDRY, Louisiana	
STEVE SOUTHERLAND II, Florida	
JEFF DENHAM, California	
JAMES LANKFORD, Oklahoma	
REID J. RIBBLE, Wisconsin	
CHARLES J. "CHUCK" FLEISCHMANN, Tennessee	

SUBCOMMITTEE ON ECONOMIC DEVELOPMENT, PUBLIC BUILDINGS, AND EMERGENCY
MANAGEMENT

JEFF DENHAM, California, *Chairman*

TIMOTHY V. JOHNSON, Illinois	ELEANOR HOLMES NORTON, District of Columbia
ERIC A. "RICK" CRAWFORD, Arkansas, <i>Vice Chair</i>	HEATH SHULER, North Carolina
RANDY HULTGREN, Illinois	MICHAEL H. MICHAUD, Maine
LOU BARLETTA, Pennsylvania	RUSS CARNAHAN, Missouri
BOB GIBBS, Ohio	TIMOTHY J. WALZ, Minnesota
PATRICK MEEHAN, Pennsylvania	DONNA F. EDWARDS, Maryland
RICHARD L. HANNA, New York	BOB FILNER, California
CHARLES J. "CHUCK" FLEISCHMANN, Tennessee	NICK J. RAHALL II, West Virginia <i>(Ex Officio)</i>
JOHN L. MICA, Florida <i>(Ex Officio)</i>	

CONTENTS

	Page
Summary of Subject Matter	iv

TESTIMONY

Kotz, Hon. H. David, Inspector General, U.S. Securities and Exchange Commission	4
Schapiro, Hon. Mary L., Chairman, U.S. Securities and Exchange Commission	4

PREPARED STATEMENTS SUBMITTED BY WITNESSES

Kotz, Hon. H. David	30
Schapiro, Hon. Mary L.	38

SUBMISSION FOR THE RECORD

Letter from Hon. Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission, to Hon. Jeff Denham, a Representative in Congress from the State of California, clarifying information on p. 10, paragraphs 15-17 of this hearing, which has been reformatted from the original transcript for publication and attached for reference. The passage appeared in the original transcript on page 25, lines 556 to 566, as indicated in Hon. Schapiro's letter.	47
---	----



U.S. House of Representatives
Committee on Transportation and Infrastructure

Washington, DC 20515

John L. Mica
Chairman

Nick J. Rahall, III
Ranking Member

July 1, 2011

James W. Coon II, Chief of Staff

James H. Zeta, Democrat Chief of Staff

BRIEFING MEMORANDUM

TO: Members of the Subcommittee on Economic Development, Public Buildings, and Emergency Management
FROM: Subcommittee on Economic Development, Public Buildings, and Emergency Management Staff
SUBJECT: Oversight Hearing on "The Securities and Exchange Commission's \$500 Million Fleecing of America: Part Two"

PURPOSE

The Subcommittee on Economic Development, Public Buildings and Emergency Management will meet on Wednesday, July 6, 2011, at 2:00 pm in 2167 Rayburn House Office Building to receive testimony from the U.S. Securities and Exchange Commission (SEC) and the SEC Inspector General (SEC IG). The hearing will focus on the SEC's management of its independent authority to lease space and, in particular, the Subcommittee will examine issues detailed in a May 16, 2011, SEC IG report related to SEC's most recent lease procurement of 900,000 square feet of space in the District of Columbia under a 10-year lease worth over \$500 million.

BACKGROUND

Prior Hearing

On June 16, 2011, the Subcommittee held a hearing on the SEC's lease and the witnesses included the SEC Inspector General, the SEC Chief Operating Officer (COO), the SEC General Counsel, and a leasing representative from the General Services Administration (GSA). At the hearing, the SEC's COO and General Counsel could not answer key questions related to the SEC lease and the circumstances surrounding the sole source procurement worth over \$500 million. As a result, the Subcommittee will hold the hearing on July 6th as a follow-up hearing and will include testimony from the Chairman of the SEC.

Public Buildings and Leases

The Subcommittee has jurisdiction over public buildings, including all of GSA's real property activity through the Property Act of 1949, the Public Buildings Act of 1959, and the Cooperative Use Act of 1976. These three Acts are now codified as title 40 of the United States Code. The GSA's Public Buildings Service (PBS) is responsible for the construction, repair, maintenance, alteration, and operation of United States courthouses and public buildings of the Federal Government. Additionally, PBS leases privately owned space for Federal use. GSA owns or leases 9,600 assets and maintains an inventory of more than 362 million square feet of workspace. GSA acts as the "landlord" for the federal government, obtaining and managing space to meet the space needs of other federal agencies. GSA, however, is just one of nine¹ federal agencies that, in total, own or manage 93% of federal real property.

While GSA has generally been the "landlord" for the federal government for civilian properties, over time several agencies have obtained their own authority independent of GSA to procure and lease new space. As a result, authority to lease space has proliferated and, in some cases, to agencies that neither have the mission nor expertise to appropriately manage such authority. The SEC is one of those agencies that has been granted this authority.

SEC's Lease of 900,000 Square Feet at Constitution Center

On July 28, 2010, the SEC entered into a sole source lease for 900,000 square feet of space with an option to lease 500,000 additional square feet at Constitution Center located at 7th and D Streets, SW, in Washington, D.C. (A timeline related to the leasing of Constitution Center is attached). The SEC's rationale for the need for new space related to passage of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) which expanded SEC's responsibilities. The \$556 million lease was "negotiated" in three business days and signed on July 28, 2010 and not long after it was signed questions were raised regarding whether the SEC needed the space. The building is owned by David Nassif Associates (Landlord) and is the former location of the Department of Transportation headquarters. The building was completely renovated by the Landlord to be a modern, efficient class A office building, reportedly exceeding Level IV security standards and is expected to be rated LEED Gold, a top green building certification. Following reports of the lease agreement, the SEC IG initiated an investigation into the lease. On May 16, 2011, the SEC IG concluded its investigation and, at the request of the Subcommittee, the SEC released the report to the Subcommittee.

¹ The other major land-holding departments and agencies include the Department of Defense, Veterans Affairs, Department of Energy, Department of Homeland Security, Department of the Interior, Department of State, National Aeronautics and Space Administration, and the U.S. Postal Service.

Findings and Recommendations of the Inspector General

In the report, the SEC IG concluded: “[w]e found that OAS [Office of Administrative Services at SEC] grossly overestimated the amount of space needed at SEC Headquarters for the SEC’s projected expansion by more than 300 percent and used these groundless and unsupported figures to justify the SEC committing an expenditure of \$556,811,589 over 10 years.”² In fact, in the course of the SEC IG’s investigation, one SEC Realty Specialist described the standard used to develop the needed space figures “as a ‘WAG’ (wild-ass guess) and a ‘back of the envelope’ calculation.”³

After the SEC recognized that it may not have needed the leased space, the Landlord worked with SEC to allow other federal agencies to assume portions of the lease. Since then, the Office of the Comptroller of the Currency (OCC) and the Federal Housing Finance Agency (FHFA) entered into leasing agreements for space at Constitution Center, leaving approximately 350,000 square feet remaining on SEC’s lease. The Landlord, however, has claimed that SEC’s actions have caused it to incur damages totaling more than \$93 million.⁴

Key Findings of the Inspector General

- **Inflated Staffing Numbers:** SEC inflated the projected numbers of future employees, contractors, interns, and temporary workers to justify its space requirements, by assuming:
 - all new SEC positions would be located in D.C.;
 - a ratio of 20% -- contractors to employees (twice as much as is standard);
 - a ratio of 16.5% -- interns and temporary workers to employees, more than 3 times more than the actual ratio;
 - a 10% growth or “inventory” factor, double the standard;
 - SEC would obtain approval from OMB and Congress for the full SEC staffing appropriation requests for FY2011, FY2012 and a 50% increase for FY2013.
- **Inflated Space Standards:** SEC further inflated the space requirements by using a standard of 400 square feet per person for needed space (GSA recommends 230 or lower)⁵. The use of this figure results in further inflation of the projected number of people. For example, the 400 square foot figure already includes 5% for growth and 10% for contractors and temporary workers.
- **Inflated Numbers Cut Viable Alternatives:** As a result of the inflated numbers, SEC’s initial estimates that reflected a need for less than 300,000 square feet increased to more than 900,000 square feet. This led to the exclusion of a number

² *Improper Actions Relating to the Leasing of Office Space, Report of Investigation*, Office of the Inspector General, U.S. Securities and Exchange Commission, May 16, 2011 (OIG-553), p. 2.

³ *Id.* at p. 5.

⁴ *Id.* at p. 10.

⁵ *Id.* at p. 32.

of available commercial buildings in walking distance to the current SEC Headquarters near Union Station.

- **Lease Not Negotiated:** SEC signed an un-negotiated, 10-year lease just 5 days after approval by the Chairman of the SEC which was obtained in a meeting lasting approximately 10 minutes. The rush to sign the contract also led to the omission of standard lease terms intended to protect the government.
- **Violation of Contracting Rules:** SEC did not follow requirements of the Competition in Contracting Act (CCA) and the Federal Acquisition Regulations (FAR) that require full and open competition. An exception to this requirement can be “when the agency’s need for the supplies or services is of such an unusual and compelling urgency that the Government would be seriously injured unless the agency is permitted to limit the number of sources from which it solicits bids or proposals.”⁶ The SEC IG concluded there was no unusual or compelling urgency or that the Government would be seriously injured had full and open competition occurred. In addition, the SEC IG found the *Justification and Approval For Other Than Full and Open Competition* generated by the SEC was publically noticed more than five weeks after the contract was signed (beyond the 30-day period required in the FAR); was backdated to make it appear it was approved earlier than it was; and had at least one date altered. Moreover, three of the four signatures required were signed separate from the document for which the signatories were attesting.
- **Lack of OMB Approval:** SEC may not have complied with OMB requirements for government leases by not submitting information to OMB pursuant to Appendix B of the OMB Circular No. A-11.
- **Possible Violation of Anti-deficiency Act:** The SEC may have violated the Anti-deficiency Act that prohibits officers or employees of the government from entering into an obligation or contract before an appropriation is made unless otherwise authorized by law.
- **Work Environment Discourages Questions:** The SEC IG found evidence of a rigid, closed, and hostile atmosphere within the Office of Administrative Services (OAS) (the SEC office responsible for leasing) that suggested employees with relevant experience were discouraged from questioning decisions.

Recommendations of the Inspector General

The IG recommended that the SEC:

⁶ Id. at p. 68 (quoting 48 CFR § 6.3202-2).

“...carefully review the report's findings and conduct a thorough and comprehensive review and assessment of all matters currently under the purview of OAS including, but not limited to:

- (1) The adequacy of written policies and procedures currently in place for all aspects of the SEC's leasing program, including, but not limited to, putting in place written procedures for leasing approvals;
- (2) The methods and processes utilized to accurately project spacing needs based on concrete and supportable data;
- (3) The determination to employ a standard of 400 square feet per person for planning Agency space needs;
- (4) The necessity of retaining architects, furniture brokers, or other consultants to assist in the work generally performed by OAS officials; and
- (5) All pending decisions in which OAS is committing the SEC to expend funds, including decisions relating to regional office lease renewals.⁷”

The SEC IG further recommended that the “Chief Operating Officer/Executive Director, upon conclusion of such review and assessment, determine the appropriate disciplinary and/or performance-based action to be taken for matters that are discussed in this report of investigation, as well as any other issues identified during the review and assessment, including, at a minimum, consideration of disciplinary action against Sharon Sheehan and, up to and including dismissal...”⁸

Finally, the SEC IG recommended that the “Office of Financial Management, in consultation with the Office of General Counsel, request a formal opinion from the Comptroller General as to whether the Commission violated the Anti-deficiency Act by failing to obligate appropriate funds for the Constitution Center lease.”⁹

SEC's Response

Since the IG report was issued, the SEC indicates that it has taken a number of steps to comply with the IG's recommendations. SEC maintains they are in the process of taking disciplinary action against key employees involved; they are engaging an outside consulting firm to review their policies and procedures related to lease procurements; that they are in discussion with GSA to have them procure space on behalf of the SEC going forward; and, on June 15, 2011, the SEC sent a letter to the General Accountability Office (GAO) regarding questions of Anti-Deficiency Act violations.

In addition, since the June 16th hearing, the SEC has been working to Subcommittee staff on responding to questions and information requests.

⁷ Id. at p. 90.

⁸ Id.

⁹ Id. at p. 91.

Problems Related to SEC Leases Pre-Date Constitution Center Lease

In 1990, Congress provided the SEC with independent leasing authority with the intent that such authority would be “exercised vigorously by the Commission to achieve actual savings and to increase the Commission’s productivity and efficiency.”¹⁰ Despite this responsibility, the SEC did not establish a Leasing Branch until 2009, 19 years after being granted this authority. The SEC currently leases space in 12 cities¹¹ and the District of Columbia. These include its headquarters in D.C. and regional offices. The SEC manages approximately 2.4 million square feet of space at an average annual cost of \$83 million. Questions regarding SEC’s management of its leasing authority date back more than a decade. Some examples include:

- In 2001, the SEC leased space for its Regional Office in New York City and subsequently entered into a dispute with the landlord regarding the handling of asbestos allegedly found in the building. While the lease agreement assigned responsibility to the landlord, instead of addressing the issue, in 2004, the SEC issued a *Justification and Approval for Other than Full and Open Competition* to enter into a sole source lease agreement for other leased space. While SEC subsequently worked with GSA and the landlord to mitigate the costs, the SEC has paid more than \$15 million since 2005 for space that SEC has not occupied since that time.¹²
- In 2001, the SEC entered into a lease for new headquarters in D.C., known as Station Place One and subsequently exercised an option to lease Station Place Two. In 2005, SEC disclosed to the House Appropriations Committee that it had approximately \$48 million of unbudgeted costs associated with the construction of the new facilities in D.C. and improvements in new leased facilities in New York and Boston.¹³
- In 2007, the SEC embarked on a “restacking” project at its D.C. headquarters building. Restacking is the movement of employees from one physical location in the building to another for purposes of better collaboration between employees. While the then-Chairman of the SEC requested that the Executive Director conduct a cost-benefit analysis prior to restacking or moving approximately 1,700 employees and initiating

¹⁰ *Improper Actions Relating to the Leasing of Office Space, Report of Investigation*, Office of the Inspector General, U.S. Securities and Exchange Commission, May 16, 2011 (OIG-553), p. 19 (quoting House Conf. Report 101-924).

¹¹ These include Atlanta, Boston, Chicago, Denver, Fort Worth, Los Angeles, New York, Philadelphia, Salt Lake, San Francisco, and Alexandria (VA).

¹² See *Real Property Leasing Procurement Process*, Office of Audits, Office of the Inspector General, U.S. Securities and Exchange Commission, September 30, 2010 (Report No. 484).

¹³ See *U.S. Securities and Exchange Commission: Building Project Management and Related Budget Planning*, U.S. Government Accountability Office Letter to The Honorable Frank R. Wolf, Chairman, Subcommittee on Science, the Departments of State, Justice, and Commerce, and Related Agencies, Committee on Appropriations, U.S. House of Representatives, October 20, 2005 (GAO-06-61R).

reconstruction, there is no evidence that a cost analysis was ever completed. The restacking cost the taxpayers \$3 million and there is no evidence the restacking improved efficiency.¹⁴

- In 2009, the SEC's lease for the San Francisco Regional Office was expiring and despite taking steps to exercise a one-year extension while it conducted a full and open competition for replacement space, the extension was never executed and the SEC began paying a higher holdover lease rate. Subsequently, the SEC awarded the new lease to the existing landlord which allowed the SEC to negotiate a credit for the higher rate paid. However, SEC still paid excess rent totaling over \$200,000.¹⁵

WITNESSES

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission

The Honorable H. David Kotz
Inspector General
U.S. Securities and Exchange Commission

¹⁴ See *Review of the Commission's Restacking Project*, Office of Audits, Office of the Inspector General, U.S. Securities and Exchange Commission, March 31, 2009 (Report No. 461).

¹⁵ See *Real Property Leasing Procurement Process*, Office of Audits, Office of the Inspector General, U.S. Securities and Exchange Commission, September 30, 2010 (Report No. 484).

**THE SECURITIES AND EXCHANGE
COMMISSION'S \$500 MILLION
FLEECING OF AMERICA: PART TWO**

WEDNESDAY, JULY 6, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT, PUBLIC
BUILDINGS, AND EMERGENCY MANAGEMENT,
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,
Washington, DC.

The subcommittee met, pursuant to call, at 3:17 p.m., in room 2167, Rayburn House Office Building, Hon. Jeff Denham (chairman of the subcommittee) presiding.

Mr. DENHAM. The subcommittee will come to order.

First, let me thank Chairman Schapiro of the SEC for being here today to testify on this important subject; and I would like to welcome back Mr. Kotz, the SEC inspector general, and thank him again for all the work his office has done in investigating the SEC's use of leasing authority.

On June 16th, the subcommittee held a hearing regarding the SEC's leasing of over 900,000 square feet of space at Constitution Center in DC. We expected to get answers to some basic questions as to how and why the SEC managed to bind the taxpayer to more than \$500 million in lease payments for space the SEC did not even need. Sadly, we didn't get very many answers last hearing, despite having the SEC's chief operating officer and general counsel both testify. Few of our questions were answered.

In the private sector, if an employee bound their company to a contract costing over \$500 million it did not need, that company would want to know the facts to determine who all should be held accountable and how to prevent it from happening again.

Federal agencies should be held to an even higher standard as, ultimately, it's the American people who pay for their costly mistakes. While the IG who is here to testify today did a thorough job in his investigation on this lease, our subcommittee expected to be able to get answers directly from Agency leadership at our last hearing.

Some of the basic questions that were raised included:

How and why did the SEC in the course of just 1 month more than triple the size of its space requirement?

Why did the SEC believe it was appropriate to base a procurement of a new lease on an estimated number of new employees for which there was no approved funding?

Why did the SEC assume all of the new employees would be in DC, when Chairman Schapiro had previously indicated nearly half would be assigned to the regional offices?

Why didn't the COO or other officials at the SEC ask questions regarding the increase in projected lease payments?

What facts substantiated the SEC's decision to sole-source contract?

Why was a sole-source contract worth more than \$500 million negotiated over the course of just a couple of days?

Why didn't the lease contract include any clauses to protect the taxpayer, such as a cancellation clause?

And why is there nothing in writing that would show a formal internal approval of such a massive lease?

These are some of the basic questions that still have not been answered.

I would like to say for the record that since the June hearing Chairman Schapiro has taken steps to try and ensure that as many of these questions as possible were answered before this hearing today. However, information that would help to shed more light on how this particular lease was signed remains illusive; and it still remains unclear how or why, Chairman Schapiro, as head of the Agency, you verbally approved a \$500 million lease based on a 10-minute unscheduled meeting.

As I mentioned at the June hearing, the IG report is breathtaking. It is inconceivable that the SEC bound the taxpayer to more than a half billion dollars based on back-of-the-envelope calculations that were inflated and just simply wrong. And it is more disturbing that such a lease was signed without any informal internal written approval, no OMB approval, and no congressional approval. And, on top of that, the SEC proceeded with a sole-source contract negotiated over the course of just a few days based on a justification document that was backdated and altered.

As the IG noted in the last hearing, it appears someone at the SEC saw Constitution Center and decided that that's where they wanted the SEC to move, regardless of the cost to the taxpayer. And sadly, as pointed out in June, we know this is not the first time SEC has mismanaged its leasing authority. Previous IG and GAO reports have shown that the SEC has a history of making bad decisions when it comes to leasing.

Our subcommittee has been working on a bipartisan basis to cut waste when it comes to our Federal buildings, even clamping down on waste and excess building in the Federal courthouse program. The Civilian Property Realignment Act that I introduced earlier this year is intended to decrease the Federal space footprint, putting more people in less space. This legislation would also revoke the SEC's ability to make this mistake again. And the current administration, just over a month before the SEC signed this lease, issued a directive to Federal agencies to reduce space.

Reducing waste and Federal real property has been and remains a priority, and it is unclear why the SEC didn't get it. So I hope today we get the answers.

I would now like to recognize Ranking Member Norton from the District of Columbia for 5 minutes to make any opening statements she may have.

Ms. NORTON. Thank you, Mr. Chairman.

We welcome today's witnesses to a second hearing on the May 16, 2011, report of the Securities and Exchange Commission Office of Inspector General on a lease by the Agency of a large office building in Washington, DC.

Last month's hearing and the IG report painted a picture of an agency that was ill-equipped to engage in real estate transactions and consequently developed a culture that allowed bureaucrats to make major unsupported financial commitments; and, as a result, serious abuses occurred that could result in subsequent action against the employees involved, according to the IG's May 16th report.

To directly address this problem, I've introduced H.R. 2390, a bill that would remove leasing authority from the SEC.

Today's hearing will allow SEC Chair Mary Schapiro and SEC IG David Kotz to testify on the status of the IG report and to learn what actions have been taken to mitigate the damages caused by the unauthorized leasing. We also will hear what progress has been made on holding accountable any employees for their roles in the lease.

The SEC chair has indicated that she agrees that the SEC should not be engaged in leasing activity. Real estate is outside of SEC's core mission of regulating America's security systems, protecting investors, and particularly as challenged to issue and implement the rules and regulations of Dodd-Frank.

Apart from the lease that sparked the IG report, the SEC has shown over the years that leasing is a function well outside of the Agency's expertise. H.R. 2390 reflects the SEC's chair's own counsel that the SEC should remain exclusively focused on its core mission.

It is my understanding that the SEC chair has met with the General Services Administrator to ask the GSA to assume the SEC's real estate functions, as GSA does for most Federal agencies.

The first subcommittee hearing on this lease was thorough, covering the background and facts that lead to the IG report. Neither the SEC nor any party has disputed the underlying facts in the report. The SEC's corrective action plan in response to that report concurred with all of the IG's recommendations that indicated a commitment to executing the necessary remedial actions. Mainly missing from last hearing were details of the corrective action taken by the SEC. I look forward to hearing those details today, and I thank our witnesses for testifying.

Thank you, Mr. Chairman.

Mr. DENHAM. Thank you.

I now call on chairman of the full committee, Mr. Mica.

Mr. MICA. Well, thank you, Chairman Denham and Ranking Member Norton, for, first of all, your diligence in pursuing this matter and conducting these hearings at a time when we're facing some of the worst deficits in the Nation's history and struggling financially.

It's almost incredible to learn of an agency that spun out of control, and it is almost incredible—half a billion dollars in space for committing the Federal Government for 10 years to pay for space based on what appears to be inflated staff numbers, a space need

probably violating not only the rules of acquisition, procurement, or leasing but in violation of competitive contracting rules, ignoring, not consulting properly the Office of Management and Budget, violating antideficiency regulations of entering into leases. Again, very least, a questionable basis, but, again, it is astounding.

I hope that this hearing highlights what's taken place. We don't need this to ever happen again.

We also are stuck with an obligation. Now we're finding spaces are being filled—attempted to be filled. We find an obligation of maybe \$93 million in some deficiencies with the landlord. Again, I just don't think you could paint a worse scenario for obligating, again, taxpayer funds to any venture I have seen.

When Mr. Denham, myself, and Ms. Norton struggle to locate space for agencies and to relocate or acquire a space, to consolidate, we run into all obstacles. Maybe we should figure out how we could maybe enlist the SEC in handling some of these things. Unfortunately, while they are able to do it quickly and obligate substantially, it takes us years to even get small projects under way.

So I find this, again, just an outrageous misuse of public resources at a very difficult economic time. I am pleased you are pursuing this. We need to make certain a law is crafted and a regulation so that it doesn't happen again. And then, if we are obligated to this space, certainly I have some ideas on how it could be properly utilized; and I will work with the subcommittee and the committee in that regard.

I yield back the balance of my time.

Mr. DENHAM. Thank you.

Today, we'll ask that our witnesses provide testimony under oath. I would ask the witness to please stand and raise their right hand to be sworn in under oath.

Do you swear that the testimony you are about to provide to the subcommittee is the truth, the whole truth, and nothing but the truth, so help you God?

Thank you.

Our first and only panel will be the Honorable Mary Schapiro, chairman, U.S. Securities and Exchange Commission, and the Honorable David Kotz, inspector general, U.S. Securities and Exchange Commission.

I ask unanimous consent that our witnesses' full statements be included in the record.

Without objection, so ordered.

Since your testimony has been made part of the record, the subcommittee would request that you limit your oral testimony to 5 minutes.

Chairman Schapiro, you may begin.

TESTIMONY OF THE HONORABLE MARY L. SCHAPIRO, CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION; AND THE HONORABLE H. DAVID KOTZ, INSPECTOR GENERAL, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. SCHAPIRO. Chairman Denham, Ranking Member Norton, members of the subcommittee, thank you for the opportunity to testify today regarding the SEC's lease of office space at Constitution Center and the steps we are taking going forward.

Like the report of the Commission's Office of Inspector General, the subcommittee's previous hearing identified significant flaws in the SEC's leasing processes. I'm extremely disappointed by those failures and regret that they have taken us all away from our primary mission of protecting investors, facilitating capital formation, and insuring stability in the financial markets.

The fact that the SEC has not paid any rent to date for this property and that the bulk of the space has been leased to other tenants does not adequately address a situation that should never have occurred. The only appropriate response by the SEC is to resolve the remaining space issues, to correct the deficiencies in our leasing processes by working with GSA and OMB with respect to future space needs, and to ensure accountability for the events surrounding this lease.

By way of background, in the spring of 2010, the SEC correctly anticipated it would receive significant new responsibilities under the Dodd-Frank for derivatives, hedge fund advisors, creating credit rating agencies, and much more. This was, of course, on top of our longstanding core responsibilities. As a result, we believed and continue to believe that the SEC needed additional staff to fulfill its mission and to help further restore investor confidence in our markets.

At the time the Agency was considering the leasing decisions, I indicated my preference for hiring new staff in the regions, rather than at headquarters. And, I indicated to staff my preference that any new space in Washington be within walking distance of our Station Place buildings to eliminate the need for expensive shuttle services.

With respect to Commission matters in which I'm not an expert, I provide overall policy goals and instructions and leave it to the professional staff to execute them consistent with my instructions. Throughout my time, I have found the professional staff across the Agency to be extremely dedicated to their mission and knowledgeable in their areas of expertise.

In July of 2010, staff informed me that all of our other leasing options no longer existed, that the space at Constitution Center was our only option, that the pricing was advantageous, and that we had to move quickly, as there was competition for the space. Given my previous discussions with staff, I assumed the proposal was consistent, both with our budget projections for future employee growth and my preference for staff to be housed where possible in the regions. When it subsequently became clear that the SEC would not receive the funding necessary to implement its new responsibilities, we took immediate steps to release the space to others and reduce the SEC's exposure.

As chairman of the SEC, I am ultimately responsible for the actions of the Agency. My written testimony details how we have learned from the problems in our leasing process and how we intend to address these issues. I would like to emphasize a few of those items.

First, we are promptly implementing the inspector general's recommendations and already have submitted a written corrective action plan to the OIG.

Second, in light of the failures identified and questions raised by OIG and the subcommittee, the SEC recognizes the benefits of having GSA manage the Commission's future lease acquisitions. Leasing is not part of the Commission's core mission and as an agency we cannot allow it to impede that mission. GSA, by contrast, has long experience and expertise in leasing.

I recently met with the administrator of GSA and, in addition to discussing the Constitution Center space, we discussed ways in which GSA could assist the Commission on our leasing efforts going forward. GSA has indicated it was open to playing a significant role in those efforts, and our staffs are working on it now.

After discussions with GSA, we have provided them with a draft memorandum of understanding that would provide for GSA to undertake all leasing activities on behalf of the SEC.

Third, the OIG report recommended that the SEC initiate disciplinary proceedings for three individuals involved in the Constitution Center leasing process, and we have begun that process. The Office of General Counsel is actively reviewing the record from the OIG investigation and, where necessary, supplementing that investigation.

I've instructed my staff to move as quickly as the laws and regulations permit, consistent with fundamental fairness.

I expect the disciplinary recommendations with regard to employees identified by the IG will be made very soon. In the meantime, the individuals identified in the IG report have been reassigned. Their current duties do not involve leasing or any other authority that could bind the Commission, nor do they involve duties that relate to the expenditure of appropriated funds.

As I said previously, the true test of an organization is not whether things go wrong but how an organization responds to problems and whether its leaders take such opportunities to make necessary improvements. We are committed to doing that. I am, of course, happy to answer any questions that you have.

Mr. DENHAM. Thank you, Chairman Schapiro.

Mr. Kotz, you may—

Mr. KOTZ. Thank you for the opportunity to testify before this subcommittee. I appreciate the interest of the chairman, the ranking member, and the other members of the subcommittee in the SEC and the Office of Inspector General.

On June 16, 2011, I testified before this subcommittee about a May 16, 2011, report of investigation we issued into the circumstances surrounding the SEC's decision to lease approximately 900,000 square feet of office space at a newly renovated office building known as Constitution Center.

As I described in my previous testimony, we opened our investigation on November 16, 2010, as a result of receiving numerous written complaints concerning the SEC's decisions and actions relating to Constitution Center.

My previous testimony described in detail our investigative efforts, including the review of over 1.5 million emails during the course of the investigation and the testimony or interviews of 29 individuals with knowledge of facts or circumstances surrounding the SEC's leasing activities.

I also testified concerning the results of our investigation, which found that the circumstances surrounding the SEC's entering into a lease for 900,000 square feet of space at the Constitution Center facility in July 2010, were part of a long history of missteps and misguided leasing decisions by the SEC since it was granted independent leasing authority in 1990.

We further found that, based on estimates of increased funding, primarily to meet the anticipated requirements of the Dodd-Frank Act, between June and July 2010, the SEC Office of Administrative Services, OAS, conducted a deeply flawed and unsound analysis to justify the need for the SEC to lease 900,000 square feet of space at the Constitution Center facility. Specifically, we found that OAS grossly overestimated by more than 300 percent the amount of space needed for the SEC's projected expansion and used these groundless and unsupportable figures to justify the SEC's commitment to the expenditure of approximately \$557 million over 10 years.

In my earlier testimony, I described how we found that OAS prepared a faulty justification and approval document to support entering into the lease for the Constitution Center facility without full and open competition. We determined that this justification and approval document was prepared after the SEC had already signed the contract to lease the facility. Further, we found that OAS backdated the justification and approval, thereby creating the false impression that it had been prepared only a few days after the SEC entered into the lease, when in actuality it was not finalized until a month later.

Our report of investigation made numerous recommendations designed to ensure that the requisite improvements to policies and procedures are made and that appropriate disciplinary action is taken. Specifically, we recommended that the SEC's chief operating officer conduct a thorough and comprehensive review and assessment of all matters currently under the purview of OAS.

We further recommended that the chief operating officer determine the appropriate disciplinary and/or performance-based actions to be taken for matters related to findings. We specified that such disciplinary actions should include, at a minimum, action up to and including dismissal against two senior individuals and disciplinary action against a third individual.

Finally, we recommended that the Office of Financial Management, in consultation with the Office of General Counsel, request a formal opinion from the Comptroller General as to whether the Commission violated the Antideficiency Act by failing to obligate funds for the lease.

My office is committed to following up with respect to all the recommendations we made in our report to ensure that appropriate changes and improvements are made in the SEC's leasing operations as a result of our findings.

Subsequent to the issuance of our report of investigation, my office requested and received a corrective action plan with regard to the substantive recommendations we made. We will monitor the planned activities carefully to ensure that the improvements are made. We also intend to monitor the disciplinary process to ensure the individuals we identified as being responsible for the failures

and improprieties described in our report are held fully accountable for their actions.

In addition to these efforts, we have met with the newly installed acting head of OAS to provide additional information concerning the failings and deficiencies we identified in that office. As a result of this briefing, a large renovation project that had been initiated by the previous head of OAS has now been discontinued.

We understand that the chief operating officer, under Chairman Schapiro's direction, has already begun to implement the improvements needed in the SEC's leasing functions. We are confident that, under Chairman Schapiro leadership, the SEC will continue to review our report and take appropriate steps to implement our recommendations and ensure that fundamental changes are made in the SEC's leasing operations so that the errors and failings we found in our investigation are remedied and not repeated in the future.

Thank you, and I will be happy to answer any questions.

Mr. DENHAM. Thank you, Mr. Kotz.

First of all, Chairman Schapiro, could you just take this committee through your responsibilities as chairman of the SEC?

Ms. SCHAPIRO. Certainly.

As chairman of the SEC, I have responsibility for setting the policy direction in coordination with my four commissioners, who are also Presidential appointees confirmed by the Senate, for implementing the requirements of the law through rulemaking, for administration of a large enforcement program for dealing with violations of the Federal securities laws by regulated entities and by others, and I have general responsibility for the administrative functions of the Agency.

Mr. DENHAM. How large is the Agency?

Ms. SCHAPIRO. We have about 3,900 employees and a budget of about \$1.2 billion.

Mr. DENHAM. And can you walk us through the timeline on the lease in question?

Ms. SCHAPIRO. Yes, I would be happy to.

In mid-2010 our former executive director communicated a need for us to secure additional space in the District of Columbia. Under our 2010 appropriation, we were working to hire about 550 employees; and our fiscal year 2011 request would have supported several hundred additional employees. The day after the lease was signed, in fact—and I will go back—the appropriations committees actually approved a higher fiscal year 2011 appropriation than we had sought or than the President had sought that would have supported about 500 more employees.

The Dodd-Frank bill, which became law on July 21st, gave the SEC huge additional responsibilities for not only part of the \$600 trillion over-the-counter derivatives market but also for hedge fund registration and oversight as well as additional responsibilities with respect to credit rating agencies and municipal advisors.

Mr. DENHAM. What date did you say Dodd-Frank passed?

Ms. SCHAPIRO. Dodd-Frank became law on July 21st. So I just use that as part of the background about how we were thinking about leasing. It was clear in June that we would be given signifi-

cant additional—likely be given significant additional responsibilities if Dodd-Frank passed.

Mr. DENHAM. So June you started having discussions, meetings on the 2010 budget to hire 500 employees and you were looking for space for those 500?

Ms. SCHAPIRO. Under our 2010 appropriation we were already working to hire those employees.

Mr. DENHAM. And the fiscal year 2011 budget passed and there was an additional 500?

Ms. SCHAPIRO. The budget didn't pass, obviously, until much, much later. It would have supported—the request would have supported about 380 more employees. And Dodd-Frank also authorized a doubling of the Agency's budget between then and 2015. So it's part of what was going into the thinking of the Agency about what our resource needs would likely be.

In any event, in June, we discussed the options for taking additional space in Washington. I was told that there was no additional space available in our existing headquarters building. I made it very clear that I wanted to move as many additional head count as we were able to out to the regional offices where the people we regulate work and where the people that we serve, investors, live. And that to the extent we needed to take additional space in Washington, DC, that it should be within walking distance of our headquarters so we would not have to pay for an expensive shuttle system.

I understood that our need for space would be based on our budget estimates, which were much more modest than what was ultimately projected according to the inspector general's report—and that was in June. And I was not told in July, when a decision was made to go forward with Constitution Center, that the numbers had been dramatically increased. I was not walked through how those numbers in fact grew. It was presented to me as an emergency situation that we take the space at Constitution Center because all the other options we had been looking at, I was told, had disappeared, that on a rentable-square-foot basis, Constitution Center was a very good deal, that we had reserved the option in taking that space to sublease or assign that space if we were not able to use it.

And of course I assumed that the decision was fully consistent with the wishes that I had expressed and that it was fully consistent with our budget projections that had been generated our Office of Financial Management. Obviously, as we know from the inspector general's report, those numbers became greatly inflated between the June timeframe and the July timeframe.

Mr. DENHAM. I just want to establish for this committee the actual timeline of how the lease went down and what happened subsequently after that.

June—you said mid-2010. I'm assuming that's June you started having meetings?

Ms. SCHAPIRO. Probably late spring in 2010. But in June was the first meeting where we sat down to talk about what our budget projections were and what our options would be within the District of Columbia and in terms of moving employees out to the regions

where we locate most of our examination and enforcement staff, which are the two largest parts of the SEC.

Mr. DENHAM. The 2010 budget you established a need for how many employees?

Ms. SCHAPIRO. In the 2010 budget—let me give you the exact number—550.

Mr. DENHAM. Out of those 550, how many were you looking at having walking distance from the current SEC building and how many were you looking at having in the region?

Ms. SCHAPIRO. To the extent possible, we were going to put the 550 in our existing headquarters space and utilize all of that space and then some number—I'm sorry, I have to get you an exact number—to go out to the regional offices.

Mr. DENHAM. I'm just trying to get a ball park and better understand the timeline. How much space do you currently have at your current location?

Ms. SCHAPIRO. About 380 in DC and 170 out to the regions.

Mr. DENHAM. And how much space do you have currently?

Ms. SCHAPIRO. I'm told that currently we have space, I believe, for about 500 in Station Place in our existing headquarters building.

Mr. DENHAM. So you could have accommodated the entire 380 that you wanted to keep in DC at your current location.

Ms. SCHAPIRO. Yes, but I was told in June of last year that we had no space left in Station Place at all.

Mr. DENHAM. Is that where your office is?

Ms. SCHAPIRO. Yes.

Mr. DENHAM. And when did it become apparent you were going to need additional space beyond what you had originally estimated under the 2010 budget, the 550 new personnel?

Ms. SCHAPIRO. Well, as we—based on our fiscal year 2011 request—and I understand that's a request, not an appropriation—as well as the new work that was being assigned to the Agency under Dodd-Frank, it became clear in the late spring that we would need—and into the summer and certainly by the middle of the summer after Dodd-Frank passed—that we would need significant additional resources to fulfill our responsibilities under Dodd-Frank.

Mr. DENHAM. OK. Let me see if I can walk through this timeline as I understand it.

Spring, you decided you were going to need new space under the 2010 budget. June, you started having meetings. And then you saw the Dodd-Frank bill starting to get rolled out in committee—I'm paraphrasing that a little bit—saw the Dodd-Frank bill being rolled out in committee. You had your fiscal year 2011 request in at the time and then expanded that request based on the Dodd-Frank legislation which was going to pass a month later.

Ms. SCHAPIRO. Yes.

Mr. DENHAM. And based on what you thought the Dodd-Frank bill that was going to get passed on July 21st, based on that bill, how many additional employees did you feel you were going to need on top of the 550 that you already had budgeted?

Ms. SCHAPIRO. We had originally said that we would need for Dodd-Frank implementation over fiscal year 2011 and fiscal year 2012 800 additional positions.

Mr. DENHAM. That's 800 on top of the 550?

Ms. SCHAPIRO. Yes.

Mr. DENHAM. On what date was the lease signed?

Ms. SCHAPIRO. July 28th, I believe.

Mr. DENHAM. So you had your initial meeting in June. How many meetings did you have between that initial meeting and when the lease was signed on July 28th? How many meetings did you have in there with staff on the staffing requirements as well as the lease space needed for those staff?

Ms. SCHAPIRO. We had, I believe, several meetings before the June meeting. The June meeting was the one where we had the detailed discussion about the different options that we have. We were looking at 300,000 square feet at that time to accommodate what we thought under our budget projections would be about 1,000 in new staff over the next 2 years or so, between 1,000 and 1,100.

And then July was when the staff came to me. The executive director came to me with an emergency request to go forward with Constitution Center without walking me through how the numbers had grown and how they had in fact, according to the inspector general's report, and I have no reason to doubt it, been inflated rather dramatically between June and July.

Mr. DENHAM. So of the 550 new employees you thought you were going to have, 380 would be in DC, which you found out after the fact you have existing space. At the time, you didn't think you had it, so you had your staff go out and look for 300,000 square feet for those 380 employees?

Ms. SCHAPIRO. No, Mr. Chairman. With—550 employees were under the fiscal year 2010 appropriation.

Mr. DENHAM. Uh-huh.

Ms. SCHAPIRO. The additional staff that we projected that we needed—we projected that we needed—were between 1,000 and 1,100, were based on the fiscal year 2011 request and 2012 to continue to bolster our core mission responsibilities, as well as to fulfill our Dodd-Frank implementation requirements, operationalization requirements.

Mr. DENHAM. That was the additional 800 people that were needed?

Ms. SCHAPIRO. That's right.

Mr. DENHAM. You had said initially 550 were needed, before Dodd-Frank.

Ms. SCHAPIRO. Yes, 550.

Mr. DENHAM. And at the time you didn't know that you had vacant space at your current facility. So I am assuming that—

Ms. SCHAPIRO. I was told that in order to accommodate any growth for fiscal year 2011 and 2012 that we would need to take additional space, that there was no more space available in Station Place.

Mr. DENHAM. So when did your staff start looking for space?

Ms. SCHAPIRO. In the spring of 2010.

Mr. DENHAM. And when did you start having meetings with your staff on their discovery of the space?

Ms. SCHAPIRO. In the spring of 2010, with the pivotal meeting being the one in June.

Mr. DENHAM. And was Constitution Center one of those spaces they had come back with in June?

Ms. SCHAPIRO. It was one of several places. I believe there were four or so options at that time.

Mr. DENHAM. Several options at 300,000 square feet, but as you go to 900,000 square feet you become limited.

Ms. SCHAPIRO. I think that's right.

And the other options, I would say, were, as the inspector general determined, within walking distance and still available to the Agency at the point of the July decision.

Mr. DENHAM. OK. Just one final question that plays back into this timeline issue. You were also a commissioner from 1988 to 1994 when the SEC originally got its leasing authority?

Ms. SCHAPIRO. That's correct.

Mr. DENHAM. And during that time when you were commissioner, how often did you see sole-source contracts?

Ms. SCHAPIRO. I don't recall having any involvement at all in any of the leasing obligations of the Agency. I was not the chairman. So the chairman would have had the operational responsibility. I can't say I didn't have any involvement at all, but I don't recall any involvement whatsoever in the leasing process.

Mr. DENHAM. And between June and July 28th when the lease was finalized, at what point in there did you discuss sole-source contracts with your staff?

Ms. SCHAPIRO. I recall the staff telling me that, because we would qualify for using the provisions that allow for going sole source or limited competition or whatever they described it as, because of an urgent and justifiable need for the space.

Mr. DENHAM. Thank you.

I will now recognize Ranking Member Norton for 5 minutes.

Ms. NORTON. Thank you very much, Mr. Chairman.

Mr. Chairman, the problems with the SEC leasing, both in this lease and in prior leases, has been made clear, but I am concerned that there may be smoking guns with some other agencies. There are some agencies that are experienced and that should have leasing authority, like the DOD and the Veterans Administration. They've long had it, probably as long as the GSA.

Mr. Chairman, I have asked for a list of agencies that have leasing authority. I recognize in our BRAC bill—a bill that, as you know, I do support—that we would pull back all these leases, but we don't have any idea whether there is a smoking gun out there. And I'm not sure about getting bills through the House and the Senate.

I do believe bill—based on this experience as a kind of optic lesson that a bill to pull back authority from agencies like the SEC could quickly get through the House and the Senate, and I would hope that you and I could work together on such a bill.

Could I ask you how much space is there in the building that would still be charged to the SEC?

Ms. SCHAPIRO. Currently—as you know, it was originally 900,000 square feet. Two-thirds of that have been taken by two other Fed-

eral agencies, the OCC and FHFA; and they are committed for that space. So the SEC has no responsibility for that space.

There is 300,000 square feet left, and we are working very closely with GSA. They have expressed real interest in taking that space over from us. We have provided them with a draft lease. We are working to definitize that so that the transfer or assignment of the surplus to GSA can be made as quickly as possible. And they have tenants who have indicated interest in that space for whom that space aligns well with their needs. So we are we are working very hard to make sure—

Ms. NORTON. Would that be the full space?

Ms. SCHAPIRO. That would be the remainder of the space for which the SEC is currently obligated, 300,000 square feet or so.

Ms. NORTON. Has SEC been charged for any of the space now under its lease?

Ms. SCHAPIRO. Congresswoman, we have not paid any rent on that space and even the space that's remaining for which we may be obligated, the 300,000 square feet, we don't believe any rent payments would be due until the first quarter of 2013. There are costs that have been incurred in the process of taking this space for, I'm told, circuitry, telecom, some architectural and construction consulting, that totals about \$415,000. But, other than that, there have been no rent payments incurred, nor do we believe there would be any until—

Ms. NORTON. Those are the only outlays by—

Ms. SCHAPIRO. I'm sorry?

Ms. NORTON. That's the only outlay of money by the SEC?

Ms. SCHAPIRO. Yes, my understanding is \$415,000.

There is another \$127,000 for IT equipment, but that can be re-deployed elsewhere in the Agency.

Ms. NORTON. Now, with GSA taking over the leasing, assuming that MOU goes through and is approved by all concerned, who would pay for GSA to do the work for SEC?

Ms. SCHAPIRO. My understanding is that GSA charges a fee to the agencies for whom—for which it administers leasing services, and so the SEC would pay that and need to account for it obviously in its budget. My understanding is it is typically 7 percent of the annual lease payments.

Ms. NORTON. Uh-huh. The so-called corrective action plan recommends a senior review of all the leasing deals. Would that be carried out by the GSA now?

Ms. SCHAPIRO. Yes, we submitted a corrective action plan to address the IG's recommendations, and we are moving ahead on that. But on a parallel track, obviously, we are trying to negotiate this agreement with the GSA to which, as I say, they are quite amenable to taking over all of this responsibility for the SEC.

We'll have to amend our corrective action plan to account for GSA taking over responsibility for a wide range of activities under the MOU, beginning with helping decide the requirements for the Agency through running competition, doing surveys, reviewing offers, negotiating offers, establishing the competitive range, arranging for the move, any tenant improvements that are necessary, and in fact actually awarding the lease under GSA's—

Ms. NORTON. My time has expired, Mr. Chairman.

Could I ask if legal counsel—if either Ms. Schapiro or Mr. Kotz can tell us whether legal counsel was ever consulted at any time during this SEC lease process or, for that matter, were they consulted generally?

Mr. KOTZ. Yes, actually, they were. The folks from the Office of General Counsel were consulted and were involved in the process.

Ms. NORTON. Well, how do you account—is it that they, too, have no expertise in real estate law? Did they look at the regulations, for example, on how much space a Federal employee is allowed to occupy? Did they look at what the law says about competitive bidding? What kind of counsel—are you saying counsel approved what the Agency did?

Mr. KOTZ. Yes, yes, general counsel's office was involved. Reviewed the justification and approval, did not have any specific issues. They did make—

Ms. NORTON. Did you question counsel about its—

Mr. KOTZ. Yes.

Ms. NORTON. And also about its malpractice insurance?

Mr. KOTZ. We definitely have concerns about how folks in the general counsel's office dealt with this situation. Without a doubt, it is set forth at some detail in the report. We have concerns about their interpretation of the Antideficiency Act, concerns about their interpretation of OMB notification, concerns that in fact the Office of General Counsel were involved in the editing and revising of the report subsequent to when it was signed. In other words, it was at the end dated for August 2nd, but for that month between the beginning of August and the beginning of September the Office of General Counsel was editing and revising the report.

Ms. NORTON. I think it puts the Agency in a general position when its own counsel can approve details of the kind that any real estate agent could have read the rules and regulations and have advised the Agency that you're going to have a lot of problems with this lease.

Mr. Chairman, I must say if the testimony is that even legal counsel not only approved but was involved in this matter, that raises very serious concerns about—I say as a member of the DC bar—about whoever is—his confidence.

But it does say to me that the notion of any agency, unless approved by this committee, having this responsibility should now be altogether clear. Because there is no check even in the Agency of the kind that I must tell you the run-of-the-mill lawyer in DC could, without ever having picked up anything but the regulations, could have spotted violations here. So it is very disconcerting.

Mr. DENHAM. Just to clarify, Mr. Kotz, are you saying that legal counsel was not only aware of the sole-source contracts but also aware that there were two different contracts out there that had been altered?

Mr. KOTZ. We didn't determine that legal counsel were aware of the altering. They were certainly aware of the justification and approval, the language in the justification approval, edited it, and eventually consented to it going forward. But we were not aware specifically that they knew about the fact that it was backdated.

I would say that one of the benefits of Chairman Schapiro's approach to hand everything over to GSA is—I would assume GSA

has its own lawyers, and so GSA lawyers would be involved in a continuing process of advising on leases, rather than the same lawyers who were involved in this case.

Mr. DENHAM. Sure. We're trying to both understand not only the future corrective action but what happened here that went so wrong. And if they didn't look at both contracts, which contract did they look at?

Mr. KOTZ. What happened was there was a version being sent around that was circulated for comment. None of the Office of General Counsel folks actually had to sign the document. So the signature page was sort of dealt with separately. They were dealing with the actual document, the language in the document.

Mr. DENHAM. Is that customary, that you have legal counsel look at a partial document?

Mr. KOTZ. Well, I don't know that legal counsel at that point was aware the document had already been signed. I think they assumed that the document had not been officially formally signed.

Now they should have looked at it certainly afterwards to see that the signature date was August 2nd, and they certainly knew that they were revising it, making comments on it way past August 2nd. So in that case they certainly should have been aware.

Mr. DENHAM. So did legal counsel have final sign-off on the contract?

Mr. KOTZ. Yes.

Mr. DENHAM. And they had an opportunity to look at the contract earlier but not a complete document?

Mr. KOTZ. What we are talking about here is the justification and approval, just to be clear. The letter contracts they also were involved in, but the document that was backdated was the justification and approval. But, yes, they had legal clearance over that document as well as the actual contract.

Mr. DENHAM. So are you saying then they saw the sole-source contract—which the sole-source contract is only determined by the date of the signature page. They saw the sole-source contract without the signature page? How is it a sole-source contract if it doesn't have a signature page? That's my question.

Mr. KOTZ. Right. It was a sole-source justification. It had a signature page. The document was sent around to various people through email requesting comments on the actual document. But the email version that was sent around didn't have the signatures on it. They were revising the substance of the document. But they should have seen at the end that, once the document was finalized, it was dated a month before they had made comments.

Mr. DENHAM. In a sole-source contract, the date is probably the most critical part, is it not?

Mr. KOTZ. It is certainly a very important part, yes.

Mr. DENHAM. OK. So they did have an opportunity to look at that contract, but the date was not on there.

Mr. KOTZ. Right.

Mr. DENHAM. So you can't justify a sole-source contract without that date.

Mr. KOTZ. Right.

Ms. NORTON. Mr. Chairman, I would say the justification—the date is very troubling, particularly for counsel when you under-

stand his responsibility. But even more troubling are explicit Government regulations on when a sole-source contract can be entered into.

I've been on this committee ever since I've been in Congress. I have never seen a sole-source contract. When people come to us for sole source, the only thing I have seen possible to do is, if someone wants to do a win-win, we build something for the Federal Government; in return, the Federal Government gets something.

You can call that a sole source if you want to, but there is not even discussion when there is a sole-source contract. So you would have to have such justification for it. And if the justification was we can't find any more space, that would not be enough justification. That would not—we can't find any other space, that would—then they would say, you better look in the region. They would say, you better look outside of the Washington. But you cannot tell us there is not one other building. You better divide them up. Because the Government does not do sole-source contracts.

Yes, the backdating, the date raises very serious problems. My problems start with the moment you know you are doing a lease, you get out your little book; and the little book tells you what the rules of the Federal Government are in doing a lease. Once you get to sole source, then of course you have got the biggest, reddest flag of all.

So while I see that there were multiple people involved, I am more shocked that counsel would have had anything to do with this matter; and it only tells me that there's nobody in the Agency—in an agency which does not have this as its mission to check, to see whether or not the mission is being carried out according to law.

Ms. Schapiro, did you have something to say?

Mr. DENHAM. Before you respond, we're going to move to Mr. Hanna and come back.

Mr. Hanna.

Mr. HANNA. Chairman Schapiro, I have a question that—the space is rented out, is about to be rented out fully. The 10-year period, \$500 million—are the current tenants and the anticipated tenant, how much of that will they cover? And, also, what do you expect your organization and the American public to have to pay into this that is associated with this mistake?

Ms. SCHAPIRO. Thank you, Congressman.

My understanding is that the two agencies that have taken the two-thirds of space, that has already been released by the SEC, and the SEC is now held harmless for that. We received a release from the landlord for that space. They are paying, actually, I think a little bit more in rent than the SEC was going to pay. So that is covered for two-thirds of the space.

The final one-third of the space is that which we're working with GSA to find other tenants for; and my understanding is that GSA is optimistic that we will be able to do that before rent is due on that space, which is not until the first quarter of 2013. So we're not across the finish line on this yet, but we are working extremely hard and extremely well with GSA and their tremendous expertise and capability to get this space entirely into the hands of tenants who can use it and use it in the timeframe in which it is available.

Mr. HANNA. So do you have a number of dollars in your mind?

Ms. SCHAPIRO. I don't believe—and, of course, these things play out over time. I don't believe the SEC will ultimately be responsible for any costs, other than those that have already—the \$415,000 I referenced earlier in response to Congresswoman Norton, other than that.

As I said, we were released on the two-thirds space that have already been relet to other tenants and at a higher rate and for a longer term. So we believe, again, that we will not be responsible for additional costs. But I certainly could not guarantee that. It will be my goal to achieve that as best we can, but we'll have to see over time. But our best guess is we should be OK on that.

Mr. HANNA. Thank you. I yield back.

Mr. DENHAM. Thank you.

Chairman Schapiro, the 900,000 square feet that was under lease, you have that broken up how now of different tenants that are willing to take that space?

Ms. SCHAPIRO. Two-thirds—and I can get for you the exact amount for each of those two agencies—went to the Office of the Comptroller of the Currency and the Federal Housing Finance Agency. They are two self-funded agencies. And they took two-thirds of that space directly as a result of the SEC having the ability to assign or sublet that space. We gave a release to the landlord, and the landlord in turn released us so that he could deal directly with those two agencies on that space. Those terms of those leases are, I believe, 15 years and up to 25 years—15 for both, I'm sorry, for both of those.

Mr. DENHAM. And both of those two agencies have their own leasing authority?

Ms. SCHAPIRO. Yes.

Mr. DENHAM. Were those two agencies in competition with the SEC in the initial bid?

Ms. SCHAPIRO. No, I don't believe so.

Mr. DENHAM. What other Government agencies were? You talked about this increased competition that forced you to go out and—

Ms. SCHAPIRO. I believe NASA was one, Mr. Chairman. I'm not sure about the other. Again, I would be more than happy to get that information.

Mr. DENHAM. How many, approximately, different agencies were in competition for such a large space?

Ms. SCHAPIRO. Two, I believe. Again, I would be happy to confirm that for you.

Mr. DENHAM. So these two, the Comptroller and the Federal Finance Agency, took 600,000 square feet, approximately?

Ms. SCHAPIRO. Yes.

Mr. DENHAM. The other 300,000 square feet the SEC is still on the hook for, but you—

Ms. SCHAPIRO. We are working with the GSA in order to surplus that or assign that space to them for them to then use as part of their portfolio. And we are told that they have potential tenants who have expressed an interest in the space and for whom the timing of that space becoming available works.

Mr. DENHAM. Another or several Federal agencies that would be going through GSA.

Ms. SCHAPIRO. Yes, and I don't know who those are.

Mr. Chairman, I want to make sure I was clear on the budget questions you asked me at the beginning. For our request, our authorization request for fiscal year 2011 and 2012 would have supported 380 additional positions in fiscal year 2011 and 800 positions in fiscal year 2012. And I'm not sure if I got you there the way I went through it before, but I wanted to make sure that was clear.

After we were on the continuing resolution or it became clear we would be on a continuing resolution, in an anomaly request that we filed with OMB at the very end of September of last year we reduced—we looked at 523 positions for fiscal year 2011 and reduced the fiscal year 2012 number to 525. The reason the fiscal year 2011 number went up from 380 to 523 was that, in the interim, the House and Senate Appropriations Committees had in fact approved a higher appropriation for the SEC for fiscal year 2011 that would have supported that 523 positions—I'm sorry. It was the OMB request in September.

The reason I think it is important is that my assumption was that the executive director's office was basing leasing needs and decisions upon those numbers which total around 1,000 additional positions, not the 2,500 or more that they ultimately used to justify the larger space.

Mr. DENHAM. The executive director Diego Ruiz.

Ms. SCHAPIRO. Yes.

Mr. DENHAM. Who is no longer with the Agency?

Ms. SCHAPIRO. He is on terminal leave, but he has been gone from the Agency for the last couple of months.

Mr. DENHAM. I want to get back to the timeline issue, because I think that it's really important, especially as we're assessing accountability in this matter. You went—your thought process was April-May expanding under just normal circumstances by 550 new employees.

Ms. SCHAPIRO. Under our 2010 appropriation.

Mr. DENHAM. And you felt you needed 300,000 square feet for a percentage of those employees because a percentage of them was going to go out to the regions?

Ms. SCHAPIRO. A large percentage was going to go out to the region, but to be clear, the 300,000 was not just predicated on needing those additional people. That would not by any means justify an additional 300,000 square feet. The 300,000 square feet was predicated, or should have been predicated, on an expectation of achieving the additional employees that were sought under the FY 2011 and 2012 request, the 1,000 or so additional employees.

Mr. DENHAM. Something grossly went wrong in June. In June you had your meeting to discuss the square footage for those new employees under the 2010 budget, and without having a 2011 budget, just a request, because the 2011 budget didn't get addressed until after the election; the 2012 budget, which we had CRs on, went beyond that; and Dodd-Frank didn't pass until July 21st. So at some point without a budget and without a Dodd-Frank bill, we were out there negotiating a lease on behalf of the American taxpayers for 900,000 square feet.

I'm trying to understand the timeline. How did things go so wrong in a 1-month period when Dodd-Frank hadn't even passed?

I would understand if Dodd-Frank had passed and you said, “Oh, no, we’re going to need a lot of new employees because the President has signed this new bill into place, and we have a new budget to pay for that, I’ve got to go out there and ramp up.” But this is prior to legislation, and this is prior to a budget. I don’t understand how in 1 month we could not only go out and secure the space, but do it over a weekend and do a sole-source contract.

Ms. SCHAPIRO. Mr. Chairman, I don’t disagree that this was done in an anticipatory way that—and should not have been done that way. I think part of what was going on is that we did try to protect ourselves to some extent with the right to assign or sublet the space that was built in.

I also—I also believe that we were——

Mr. DENHAM. Was there a cancellation clause?

Ms. SCHAPIRO. No, there was not a cancellation clause, just——

Mr. DENHAM. Because that’s normally what we put into a contract to protect the taxpayers.

Ms. SCHAPIRO. And I think it would be a great idea, frankly. I’m not sure that it’s possible. I’ve been told that such clauses are incompatible with a long-term lease such as this, and that GSA, in fact, doesn’t typically include them is what I understand from GSA. But I will agree with you that it would have been a very good thing to have in this lease; that if there were not an appropriation, the SEC would not be obligated under the contract.

Mr. DENHAM. Mr. Kotz, is it customary to have a—such a clause?

Mr. KOTZ. Yeah, I don’t know how customary it is. I mean, I think what happened in this instance was they didn’t specifically even request the cancellation clause. We were told that they didn’t because the landlord would never agree to it. We also asked that they would have a clause in there that would have the payment dependent upon appropriations. So if the appropriation came through, they would have to pay. If the appropriation didn’t come through, they wouldn’t have to pay. But they never even raised that with the landlord. Part of the problem was they—it wasn’t a very serious negotiation. They felt that they had no leverage because they wanted that space so much.

So I don’t know that I can say that it’s customary, but I do think that the process they went forward in that case was such that they didn’t really negotiate hard on behalf of the SEC. They allowed whatever terms the landlord could dictate, and the landlord certainly would have been happy not to agree to a cancellation charge, cancellation clause because that wouldn’t have been in his interest.

Ms. SCHAPIRO. Mr. Chairman, just—I’m sorry.

Mr. DENHAM. My time has expired.

Mr. Fleischmann.

Mr. FLEISCHMANN. Thank you, Mr. Chairman. I’ve got a few questions. This is very concerning to me, of course. A few issues.

It appears to me that the Agency is attempting to mitigate the damages after the fact. Is the same Office of General Counsel that was allegedly responsible for reviewing these documents overseeing this mitigation process, Mr. Kotz?

Mr. KOTZ. I believe the—I don’t know how involved the Office of General Counsel is in the mitigation process, but I—it’s the same.

There is only one Office of General Counsel. I don't know whether it's the same individual lawyers or not, but it's the same office.

Mr. FLEISCHMANN. OK.

Ms. SCHAPIRO. Congressman, if I could just add to that. If he—in terms of the mitigation process, you mean releasing the space to GSA and working on the memorandum of understanding to off-load all of our leasing responsibilities to them. I personally have met with the GSA Administrator. There are staff from the Office of the General Counsel, but also from our new Chief Operating Officer's office deeply involved in this, and I am personally involved in it. So we are very—and obviously GSA is deeply committed to the process as well, so there are a number of people who are involved in pushing these initiatives forward.

Mr. FLEISCHMANN. Then is it fair, Chairman, to assume then that this lease has a sublease provision so that you can, in fact, go ahead and sublease legally binding to other Government agencies?

Ms. SCHAPIRO. Yes. My understanding is that we have the right to assign or to sublease the space, and, in fact, two-thirds of it have, in fact, been leased to other agencies.

Mr. FLEISCHMANN. OK. In terms of the contract, we talked—chairman talked about a cancellation clause. Was there any form of a liquidated damage clause? And what I mean by a liquidated damage clause is a prearranged penalty in the contract.

Ms. SCHAPIRO. I understand that there wasn't.

Mr. FLEISCHMANN. OK. Going forward, so that this problem hopefully would never occur again, what—Mr. Kotz, what has been put in place to ensure that the next time the Agency has a contract, a lease or something, that counsel is sat down at the table without just perhaps just sending it out across emails, to sit down and make sure that counsel actually sits down and approves and advises the Agency? Has that been put in place now?

Mr. KOTZ. Well, I mean, I believe with respect to leasing, the plan is to have all the leasing functions go to GSA. So with respect to leasing, the Office of General Counsel wouldn't be involved anymore, it would be GSA and their Office of General Counsel.

Mr. FLEISCHMANN. OK. What, then, specifically safeguards have you sought to put in place to avoid a situation like this happening again?

Ms. SCHAPIRO. If I may, there are a number of things we have done immediately in response. One is to provide the GSA with a memorandum of understanding that would shift responsibility for all aspects, from requirements to awarding of leases, to the GSA on behalf of the SEC. We will not enter into any lease without the GSA having taken care of the entire process for us.

I have revoked the delegations of authority that existed to the Executive Director and from the Executive Director to other employees for the ability to enter into any leases, so those would not be possible to go forward. We have engaged Booz Allen and Hamilton to come in and do a complete assessment of our entire Office of Administrative Services, including its structure, its decision-making processes, its quality controls, the level of staffing, the skills of the staff, what are our cost-reduction opportunities, what are our process-improvement opportunities, are we in compliance with the regulations, and that work is ongoing as well.

As I mentioned earlier, the disciplinary process with respect to the specific employees who are named by the IG is well under way, and we are creating at our chief operating officer level an executive steering committee on facilities management oversight, so the decisionmaking cannot be made by one person.

But, again, most importantly—and we’re implementing new policies and procedures around leasing, but most importantly, authority has been revoked from staff to enter into any real property leases.

Mr. FLEISCHMANN. Thank you, Mr. Chairman. I yield back.

Mr. DENHAM. Thank you, and I would also announce that Ranking Member Norton had to go to the floor. We’re going to continue on, going back and forth through a couple of more rounds of questioning.

I wanted to get back to the issue of typical clauses, because it’s my understanding that a cancellation clause and a clause that’s subject to appropriation are both normal and customary, both from GSA as well as other agencies. It’s also my understanding that your staff did approach the landlord or the building owner with these two requests, and he denied them. Are you aware of that?

Ms. SCHAPIRO. I am not aware of that. And, Mr. Chairman, you are far more expert in this than I am, so if those clauses are, in fact, typical, I would defer to your judgment on that.

My understanding had been that they weren’t typical in long-term real property leases, but they ought to be. It seems like a reasonable way to protect the taxpayer, and, again, it’s another reason I think why the SEC and the taxpayer will be well served by the GSA having this responsibility for this Agency and not keeping it in house.

Mr. DENHAM. And you’ve recognized the fact that, as chairman, you’re going to oversee the core function of the SEC, and that leasing authority should be something that goes back to the GSA. My concern is you may not always be chairman. Future chairmen, future Presidents who appoint future chairmen, you may have a chairman that wants to have the leasing authority back again.

In our bill, the Civilian Realignment Properties Act, we actually pull the leasing authority not only from the SEC, but several other agencies. For the future, do you foresee the SEC ever needing leasing authority back again beyond your chairmanship?

Ms. SCHAPIRO. Mr. Chairman, from my perspective, I don’t see a reason for the SEC to have that authority. There may be reasons for other agencies that I wouldn’t begin to be able to speak to, but I don’t see the need for the SEC. And frankly, I do see a benefit for the GSA to have a larger, broader, more flexible portfolio that they’re able to obtain by having more agencies underneath their responsibility, and it gives them the flexibility with the space that they have to allocate it among multiple agencies, which I think perhaps provides us, them also, with more market power when they’re negotiating leases. So from my perspective, and from the perspective of the SEC, at this time, as I’m chairing it, I don’t see the need for the SEC to maintain this authority.

Mr. DENHAM. Thank you.

We will be requesting further information on the lease itself. We will be working with GSA on that as well. We want to make sure

that the taxpayer, indeed, does not have to pay for the cost of this lease, but I also want to follow up on the disciplinary action.

Diego Ruiz, you said, the Executive Director, is on terminal leave?

Ms. SCHAPIRO. Yes, that's right.

Mr. DENHAM. How do you define "terminal leave"?

Ms. SCHAPIRO. He resigned from the Agency and, I believe, is using up accrued annual leave, as is permitted under the Government rules, but he is not in the office. He's not in our facility. He has no responsibility. In fact, I immediately reassigned all of his direct reports to the new Chief Operating Officer, and we're in the process of eliminating the Executive Director position and combining it all under the Chief Operating Officer.

Mr. DENHAM. And your Chief of Staff, I assume, sat in on a number of these meetings. Is there any responsibility of your Chief of Staff on this matter?

Ms. SCHAPIRO. No, I don't believe so. I mean, my Chief of Staff and Deputy Chief of Staff both were in some of the meetings. They were not provided with more accurate information than I was, unfortunately, or they would have noticed, I think, what was going on, but I don't believe they bear any responsibility.

Mr. DENHAM. And both your Chief of Staff and your Deputy Chief of Staff are both still with you?

Ms. SCHAPIRO. The Deputy Chief of Staff left a month or so ago, and the Chief of Staff is still there. And let me just add, she left completely unrelated to this issue or any other issue.

Mr. DENHAM. And the five signers on the document themselves?

Ms. SCHAPIRO. I'm—I don't know off the top of my head who the signers were. I mean, I focused more on the employees in terms of those identified by the inspector general in his report to be considered for disciplinary action, and to the extent, as you and I have discussed, those people are still there, the review is ongoing to follow up on the IG's report. And in the meantime the three critical people have been reassigned and are no longer responsible for any leasing activity, but also are not in positions to commit or bind the Agency in any way on any contract.

Mr. DENHAM. And who are the three individuals?

Ms. SCHAPIRO. Sharon Sheehan, who is the Associate Executive Director and the head of the Office of Administrative Services; Mr. Branch, who is the Support Services Manager; and Miss Sudhoff, who was the competition specialist. I believe those were the three who were particularly highlighted by the IG.

Mr. DENHAM. And, Mr. Kotz, you identified these three people? Were these the only three people that you identified?

Mr. KOTZ. Those are the three people we specifically identified for disciplinary action in the report, yes.

Ms. SCHAPIRO. I believe, Mr. Chairman, as you and I discussed briefly yesterday, we will not turn a blind eye. If there are other issues with respect to other employee conduct that comes up in the course of this review, obviously we'll take appropriate action.

Mr. DENHAM. Mr. Ruiz, was he identified as well for disciplinary action?

Mr. KOTZ. By that point he had resigned from the Agency.

Mr. DENHAM. He had resigned, OK.

And how about Wendy Liebl? Liebl?

Mr. KOTZ. Right. She was gone also by that point.

Mr. DENHAM. Would you have named those two?

Mr. KOTZ. Yes.

Mr. DENHAM. What about Kayla Gillian?

Mr. KOTZ. No, we wouldn't have named her.

Mr. DENHAM. OK. So just those five?

Mr. KOTZ. Right.

Mr. DENHAM. And of those five, how many more signers on the contract?

Mr. KOTZ. I believe the three people signed the contract: Sheehan, Sudhoff, and Liebl.

Mr. DENHAM. And what was that?

Ms. SCHAPIRO. Branch and Liebl as well.

Mr. KOTZ. Yeah, Branch and Liebl. So those were—

Mr. DENHAM. So everybody you've named all signed the contract?

Mr. KOTZ. Yes. It was—just to be clear, it was a justification and approval, not specifically a contract per se. But, yes, it was the document that demonstrated the sole-source nature.

Mr. DENHAM. Do we know when any of these or when each of these had actually signed the contract?

Mr. KOTZ. Yes. The justification and approval was—they were all dated August 2nd. There were several that were signed early in August. Then there was that one that Linda Sudhoff signed on August 31st, although initially it was dated August 27th, and then the 7 was whited out so made to look like it was August 2nd, but it was actually signed on August 31st.

Mr. DENHAM. Thank you.

Mr. Hanna?

Mr. HANNA. What would your—either person—what would your expectation be in terms of the nature of disciplinary action, and in your own words, what would you describe their malfeasance or misconduct to be?

Ms. SCHAPIRO. Congressman, I think it's really important that we let the disciplinary process go through without commenting or prejudging the information. And as I said, I'm very committed to us getting this completed very quickly so that the Agency can move on with their—with the transition to the GSA and the reorganization that will be necessary in the Office of Administrative Services. And I just—I guess I hate to prejudge any individual's conduct.

Mr. HANNA. Thank you. I yield back.

Mr. DENHAM. Thank you.

I'm having a hard time understanding who else should be held accountable on this issue, and I'm trying to understand your thought process on this. You went from 550 people, of which you expected a large percentage of those to be in the regional areas. It was also—in your statement you said you also wanted them, the ones that were going to be located in DC, to be within walking distance of the current SEC building. Now, this 900,000 square feet is neither in the region, nor is it within walking distance.

How do we get to the point where we're going out to lease this building; and, secondly, if you're in charge, and it was your wish to have regional or within walking distance, how did we end up with a building that was neither of those and went from 300,000

square feet to 900,000 square feet? I mean, ultimately if you're not the person to be held accountable, and neither is your Chief of Staff, you were both in meetings and both aware of these changes, and if your directive was something else than what actually happened, I'm having a hard time understanding—

Ms. SCHAPIRO. Well, Mr. Chairman, I am accountable, clearly. I will say that I was not fully aware of—I was not aware of these changes. I was not aware and nor was I walked through that we'd gone from 300,000 to 900,000 square feet. I've never even seen the Constitution Center space. I did not know that they had selected a building that was not within walking distance of the Agency, and I certainly didn't know that my express wish that we move as many employees as possible to the regions was not being honored.

I assumed that the projected space needs—and I didn't question the underlying assumptions—I assumed that they would be routine assumptions about the number of square feet per employee that are used throughout the Government and so forth. I didn't question those underlying assumptions, but I assumed that they would be in line with both our budget assumptions, which had us somewhere between 1,000 and 1,100 people over FY 2011 and FY 2012, and that the work that was being done was consistent with that. But I—at the end of the day, the staff went forward and signed a contract for far more space than was appropriate for the Agency in a location that was not ideal for the Agency, and it's why we've worked so hard now very quickly, frankly, after this was done to undo it.

Mr. DENHAM. As chair of the SEC, what is your ability to appropriate dollars?

Ms. SCHAPIRO. I have no ability to appropriate dollars. Congress obviously appropriates the funds for us in accordance with the budget that we provide to Congress, so that even when we seek to move money—

Mr. DENHAM. So then what is your spending authority?

Ms. SCHAPIRO. It is as it is outlined in the budget. So if I could give you an example, under Dodd-Frank we're required to create five new offices within the SEC. Four of those require change in reporting structure, and in order for us to create those four offices, even within the existing budget of the Agency, we have to go to the appropriators with a reprogramming request to ask for money to be reallocated to create those offices that Congress told us to create. So I'm guided by the budget.

Mr. DENHAM. So your spending authority ends with the appropriation of Congress, based on what the current fiscal year budget is?

Ms. SCHAPIRO. That's right.

Mr. DENHAM. So you went from a 2010 budget, you began negotiating the lease for the 2011 budget, which hadn't been passed yet, and the 2012 budget, which we just passed earlier this year, and—I mean—

Ms. SCHAPIRO. Congressman—

Mr. DENHAM. You can see that this doesn't make any sense. You committed the taxpayers to over half a billion dollars without Dodd-Frank passing, without the 2011 budget, without the 2012 budget. So if you're not held accountable to any disciplinary action,

nor is your Chief of Staff, I'm having a hard time understanding why the taxpayers are on the hook for half a billion dollars under this scenario when the spending authority was not granted.

Do you have some other type of spending authority outside of the budgetary process?

Ms. SCHAPIRO. No.

Mr. DENHAM. Does your staff have any other type of spending authority?

Ms. SCHAPIRO. No. The cost for the leases were included in our budgets for 2011, \$7.2 million, and for 2012 \$12.7 million for the rental payments.

Mr. DENHAM. How big is your current—was your 2010 budget?

Ms. SCHAPIRO. I believe it was \$1.1 billion.

Mr. DENHAM. \$1.1 billion. And under that \$1.1 billion, the lease payment on an annual basis would have been—

Ms. SCHAPIRO. Well, in 2011—no rent, in fact, was due until the first quarter of 2012, but there was an opportunity because we have no year money to prepay, so I believe the budgeted amounts for 2011 was \$7.2 million. Now, even though that space is gone and taken over by the other agencies, we're still budgeting for rental costs for the last 300,000 square feet, although, again, we hope that that space will be gone as well. We have not paid any rent to date.

Mr. DENHAM. I'm getting to the point where I was with your CEO—COO last week. I just—I don't understand—I don't understand how you can obligate a future Congress on a large expenditure that was not passed. We haven't passed a budget in how many months now? How long has it been since we had a budget? Over 2 years.

Ms. SCHAPIRO. But I guess we—I mean, we have lots of space now around the country that we pay rent on every year, so we have multiyear leasing authority. We have the ability, obviously, to enter into long-term leases. That's generally the most cost-effective way for the Government and for the taxpayer, and although we don't—you're right, we don't have a budget all the time, we operate under continuing resolutions, we do include in our budgeting what our lease payments and lease obligations will be for the coming year. I'm not sure how else we can go forward and lease space for our employees.

I will say that the question that was raised by the inspector general came up very briefly here about whether we properly exercised our independent, multiyear leasing authority and, by doing so, only obligate the current-year obligations is in any way a violation of the Antideficiency Act, and we have asked GAO for an opinion on that.

Mr. DENHAM. I understand the need for multiyear lease. Obviously we want to utilize multiyear lease to save taxpayers money over a long-term period of time. But what you have done and what your department has done, what your Agency has done, is take a \$1.1 billion budget and increase that by 20 percent on an annual basis based on a budget that was never passed. That's something that's very different. When you're basing your budget—when you're going to do a long-term lease, you base it on what your current budget analysis is. And I understand that there are several people on here that are facing disciplinary action that may have bumped

up the numbers or guesstimated what the numbers would be, but the ultimate sign-off authority on such a huge number, increasing your budget by 20 percent, how could you have known, especially when Dodd-Frank hadn't even passed Congress yet?

Ms. SCHAPIRO. Well, Congressman, it wasn't presented that way. It was—the authority resided with the Executive Director to sign the lease and to enter into the lease negotiations, and it was presented in quite a different way, as a very good value for—per rentable square foot, as something we needed to do based on—it turned out not to have been based on reasonable budget assumptions, but it was represented to me as based on reasonable budget assumptions, and that we reserved the right to assign or sublet the space if it was not necessary for the SEC.

I hear your frustration, and I understand it, and frankly I share it, and it's one reason I believe this Agency, which has not handled this authority particularly well over a very long period of time, shouldn't be in this business.

Mr. DENHAM. I wanted to go back to something you said earlier. We were discussing the cancellation clause and appropriation clause. I've got before me a piece of the testimony that is included into Mr. Kotz's IG report.

The question was, OK, and did you make a recommendation, that meeting with Chairman Schapiro, that the SEC enter into this lease for the Constitution Center for 900,000 square feet?

Yes.

And so Mary Schapiro verbally approved that recommendation at that meeting?

Answer: Yes.

OK. Did she ask any questions that you can recall or her staff ask any questions that you can recall?

No, not at that—not that I can recall.

You've seen the transcripts from—

Ms. SCHAPIRO. Yes. And, Congressman—

Mr. DENHAM. This is from the Executive Director, who's been reassigned or who has resigned.

Ms. SCHAPIRO. Right.

I understood that what we were doing in July was consistent with what we had talked about in June. That clearly wasn't the case. He did not walk me through how he got from 300,000 to 900,000. We did not talk about this being \$500 million over 10 years. We talked about—it was presented to me as an immediate emergency and the criticality of going forward.

Do I wish that I had stopped?

Mr. DENHAM. Let me stop you there. It was an immediate emergency. Why was it an immediate emergency?

Ms. SCHAPIRO. Because, as he explained it to me, we had no other space options within DC, and if we were going to have any growth at all, and based upon our expectations at that time, we thought we would have growth, that we had to take this space, or we would not—

Mr. DENHAM. Why did you expect it?

Ms. SCHAPIRO. Because Dodd-Frank had passed. We had had lots of favorable comments from the appropriators and others with respect to the continued growth in our budget, we had a lot of sup-

port for a reinvigorated and renewed SEC going forward, and our budget requests for FY 2011 and FY 2012 suggested to us that we would need this space.

I understand that we made a terrible mistake not waiting for an appropriation. I understand that. I think what was also weighing heavily on people's minds at that time was that when an appropriation does come, it takes a long time to get space and to build it out and to have it available to house people, and that the Agency had been criticized sometimes in the past for not hiring people fast enough and bringing them on board.

Mr. DENHAM. This much criticism?

Ms. SCHAPIRO. No. This is more than I've certainly been used to, but I appreciate that it's constructive and important criticism for us to hear.

Mr. DENHAM. We've seen the largest collapse of the real estate industry during this time period. No 2011 budget, no 2012 budget. I'm having a hard time understanding why it was such an emergency to go out and lease space without a budget, going through the type of real estate collapse that we were seeing at the time. I just don't see the emergency.

Ms. SCHAPIRO. In retrospect, I don't either, and at the time I relied on the expertise of others that I perhaps should not have relied on.

Mr. DENHAM. I assume that you were following Dodd-Frank very closely?

Ms. SCHAPIRO. Oh, yes. We have responsibility for over 100 new rulemakings, 20 studies, and large new areas of responsibility for over-the-counter derivatives, hedge funds, credit-rating agencies, municipal advisors. We will have thousands of new regulatees and trillions of dollars of assets under management for which we will have responsibility.

Mr. DENHAM. When did Dodd-Frank pass out of the House?

Ms. SCHAPIRO. July—oh, out of the House? It passed—it was signed by the President on July 21st. I'm going to guess a couple of weeks before that. I don't remember the exact date.

Mr. DENHAM. Mr. Hanna?

Mr. HANNA. Thank you, Chairman.

With all due respect, ma'am, what do you regard your own culpability to be in this matter?

Ms. SCHAPIRO. I am ultimately responsible for the operations of the Agency, and the Agency made a terrible mistake here and entered into a lease that was not fully justified, on a sole-source basis that was not fully justified, and indeed was based upon inflated numbers. And I view myself as being ultimately responsible and also responsible for mitigating the consequences of that to the greatest extent possible. And those are the steps that we've taken are to mitigate it, to turn over this responsibility to the GSA, and to offload, as we have, two-thirds of that space and the last third in partnership with GSA as quickly as we can. My goal is to make sure the taxpayers are not on the hook for this.

Mr. HANNA. Thank you for that. And I think you've taken considerable steps in that direction.

Ms. SCHAPIRO. Thank you.

Mr. HANNA. Yes, ma'am.

I yield back.

Mr. DENHAM. Mr. Kotz, is there any further testimony that you would like to add to this as far as the IG?

Mr. KOTZ. The only thing I would mention is there's been a lot of discussion about justifications and approvals for no competition, and our office is planning to conduct an audit of additional justifications and approvals that the Agency has entered into where there's been no competition to determine that that was done appropriately, given the justifications that we found—

Mr. DENHAM. Specifically within the SEC?

Mr. KOTZ. Right.

Mr. DENHAM. And, Mr. Kotz, in your opinion, the five individuals that signed the contract, that changed the dates, or the one date that was changed and the other four that were backdated, is that of criminal nature?

Mr. KOTZ. Yes. We have actually referred that matter to the Department of Justice Public Integrity Section. We've had conversations with them about that matter, and we will follow up with the Department of Justice as they see fit with respect to any criminal liability.

Mr. DENHAM. And where are they in that process; do you know?

Mr. KOTZ. They've asked for the relevant documents. We've provided them to them, and they are making determinations.

Mr. DENHAM. How long does that normally take?

Mr. KOTZ. They told us that they would get back to us relatively shortly. We haven't heard back from them yet, but it shouldn't take very long. Obviously if they decide to take the matter and bring a prosecution, that would take a significant amount of time, but it shouldn't take very long for them to determine whether to undertake an action.

Mr. DENHAM. When did you take it to the DOJ?

Mr. KOTZ. In the last few weeks.

Mr. DENHAM. Few weeks. Is that shortly in Government terms?

Mr. KOTZ. No, no, we previously sent it to DOJ in the last few weeks.

Mr. DENHAM. But you said you expect to hear back from them shortly.

Mr. KOTZ. Oh, yes, yes, yes. Certainly in the next couple weeks I would think we would hear back from them. They have indicated to us that we would have already heard back. We haven't heard back yet, but it should be, I would think, in the next couple weeks, yes.

Mr. DENHAM. So is DOJ conducting an investigation?

Mr. KOTZ. Yeah. They're looking at the information we have, and they're going to make a determination whether they want to then bring a criminal action or at least initiate an investigation to bring a criminal action. We would then cooperate with them, and then the action would go forward.

Mr. DENHAM. Thank you.

Chairman Schapiro, do you have anything else to add to the testimony today?

Ms. SCHAPIRO. No.

Mr. DENHAM. I would like to follow up one more time on the leasing authority itself. Do you think the leasing authority should go where?

Ms. SCHAPIRO. To the GSA.

Mr. DENHAM. And in the future should the leasing authority ever come back to the SEC?

Ms. SCHAPIRO. I don't believe so.

Mr. DENHAM. I will take that as an endorsement of our current legislation.

Any further questions?

Thank you. Again, I would like to thank you for your testimony today. We're going to be following up with questions for the record, and I would ask that you provide your responses in a timely manner to the subcommittee.

I would ask unanimous consent that the record of today's hearing remain open until such time as our witnesses have provided answers to any questions that may be submitted to them in writing, and unanimous consent that the record remain open for 15 days for any additional comments and information submitted by Members or witnesses to be included in the record of today's hearing. Without objection, so ordered.

Mr. DENHAM. This concludes today's hearing on the SEC. Thank you.

[Whereupon, at 3:52 p.m., the subcommittee was adjourned.]

**Written Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission**



**Before the Economic Development, Public Buildings and
Emergency Management Subcommittee of the Committee
on Transportation and Infrastructure,
U.S. House of Representatives**

**Wednesday, July 6, 2011
2:00 p.m.**

Introduction

Thank you for the opportunity to testify before this Subcommittee on the lease of Constitution Center by the U.S. Securities and Exchange Commission (SEC or Commission). I appreciate the interest of the Chairman, the Ranking Member, and the other members of the Subcommittee, in the SEC and the Office of Inspector General (OIG). In my testimony, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

Role of and Reports Issued by the OIG

The mission of the OIG is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. The OIG's audit unit conducts, coordinates and supervises independent audits and evaluations related to the internal programs and operations of the Commission. The Office's investigations unit conducts thorough and independent investigations in response to allegations of violations of statutes, rules, and regulations, and other misconduct by Commission staff and contractors.

Over the past three and one-half years since I became the Inspector General of the SEC, my Office has issued numerous audits and investigative reports involving matters critical to SEC programs and operations and the investing public. On the audit side, some of the significant reports we have issued have included an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, a review of the SEC's bounty program for whistleblowers, an analysis of the SEC's oversight of credit rating agencies, and audits of the SEC's compliance with Homeland Security

Presidential Directive 12 and its oversight of the Securities Investment Protection Corporation's activities. Investigative reports issued during this same period have addressed a myriad of issues, including the failures of the SEC to uncover the Bernard Madoff \$50 billion Ponzi scheme and the Robert Allen Stanford \$8 billion alleged Ponzi scheme, improper securities trading by Commission employees, conflicts of interest by Commission staff members, post-employment violations, unauthorized disclosure of nonpublic information, and procurement violations.

Many of the reports we have issued have identified costs savings, including questioned costs and funds that could be put to better use. The OIG has calculated that for the period from October 1, 2009 through June 30, 2011, the return on investment for the OIG (*i.e.*, total identified costs savings divided by the OIG's budget) is 64.2 to 1.

The OIG's Leasing Investigation

On June 16, 2011, I testified before this Subcommittee about a May 16, 2011 report of investigation we issued into the circumstances surrounding the SEC's decision to lease approximately 900,000 square feet of office space at a newly-renovated office building known as Constitution Center.

As described in my previous testimony, we opened our investigation on November 16, 2010, as a result of receiving numerous written complaints concerning the SEC's decisions and actions relating to Constitution Center. These complaints alleged that the decision to lease space at Constitution Center was ill-conceived, resulted from poor management practices, and was made without Congressional funding for the significant projected growth necessary to support the decision.

My previous testimony described in detail our investigative efforts, including the review of over 1.5 million e-mails during the course of the investigation and the testimony or interviews of 29 individuals with knowledge of facts or circumstances surrounding the SEC's leasing activities.

I also testified concerning the results of our investigation, which found that the circumstances surrounding the SEC's entering into a lease for 900,000 square feet of space at the Constitution Center facility in July 2010 were part of a long history of missteps and misguided leasing decisions made by the SEC since it was granted independent leasing authority by Congress in 1990. The investigation further found that based upon estimates of increased funding, primarily to meet the anticipated requirements of financial reform legislation that was enacted on July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), between June and July 2010, the SEC's Office of Administrative Services (OAS) conducted a deeply flawed and unsound analysis to justify the need for the SEC to lease 900,000 square feet of space at the Constitution Center facility. Specifically, we found that OAS grossly overestimated (by more than 300 percent) the amount of space needed for the SEC's projected expansion and used these groundless and unsupportable figures to justify the SEC's commitment to an expenditure of approximately \$557 million over 10 years.

In my earlier testimony, I also described how the OIG investigation found that OAS prepared a faulty Justification and Approval document to support entering into the lease for the Constitution Center facility without full and open competition. We determined that this Justification and Approval document was prepared after the SEC had already signed the contract to lease the Constitution Center facility. Further, we found

that OAS backdated the Justification and Approval, thereby creating the false impression that it had been prepared only a few days after the SEC entered into the lease when, in actuality, the Justification and Approval was not finalized until a month later. Additional details regarding the findings of our leasing investigation were provided in my June 16, 2011 testimony, as well as in the 91-page report of investigation with over 150 exhibits, which has been provided to the Subcommittee.

Recommendations of the OIG's Leasing Investigation

Our report of investigation made numerous recommendations designed to ensure that the requisite improvements to policies and procedures are made and that appropriate disciplinary action is taken. Specifically, we recommended that the SEC's Chief Operating Officer carefully review the report's findings and conduct a thorough and comprehensive review and assessment of all matters currently under the purview of OAS including, but not limited to:

- (1) The adequacy of written policies and procedures currently in place for all aspects of the SEC's leasing program, including, but not limited to, putting in place written procedures for leasing approvals;
- (2) The methods and processes utilized to accurately project spacing needs based on concrete and supportable data;
- (3) The determination to employ a standard of 400 square feet per person for planning agency space needs;
- (4) The necessity of retaining architects, furniture brokers, or other consultants to assist in the work generally performed by OAS officials; and
- (5) All pending decisions in which OAS is committing the SEC to expend funds, including decisions relating to regional office lease renewals.

We further recommended that the Chief Operating Officer, upon conclusion of this review and assessment, determine the appropriate disciplinary and/or performance-based action to be taken for matters related to the findings in this report of investigation, as well as other issues identified during the review and assessment. We specified that such disciplinary action should include, at a minimum, consideration of disciplinary action, up to and including dismissal, against two senior individuals, and consideration of disciplinary action against a third individual, for their actions in connection with the gross overestimation of the amount of space needed at SEC Headquarters for the SEC's projected expansion, failures to provide complete and accurate information to the Chairman's office, and the preparation of a faulty and back-dated Justification and Approval to support eliminating competition.

Finally, we recommended that the Office of Financial Management, in consultation with the Office of General Counsel, request a formal opinion from the Comptroller General as to whether the Commission violated the Antideficiency Act, by failing to obligate appropriate funds for the Constitution Center lease.

Follow-Up Efforts

My Office is committed to following up with respect to all of the recommendations we made in our report of investigation to ensure that appropriate changes and improvements are made in the SEC's leasing operations as a result of our findings.

Subsequent to the issuance of our report of investigation on May 16, 2011, my Office has requested and received a corrective action plan with regard to the substantive recommendations we made for improvements in the operations of the Office of

Administrative Services. We will monitor the planned activities carefully to ensure that the necessary improvements are made. We have also communicated with the SEC's Office of General Counsel with regard to its review of the evidentiary record to determine appropriate disciplinary action, and have provided the Office of General Counsel with records requested to assist in those efforts. We intend to monitor the disciplinary process to ensure that the individuals who we identified as being responsible for the failures and improprieties described in our report are held appropriately accountable for their actions.

In addition to these efforts, we have met with the newly-installed acting head of the Office of Administrative Services to provide additional information concerning the failings and deficiencies we have identified in that Office. As a result of this briefing, a large renovation project that had been initiated by the previous head of the Office of Administrative Services has been discontinued.

We understand that the Chief Operating Officer, under the direction of Chairman Schapiro, has already begun to implement the improvements needed in the SEC's leasing functions. We are confident that under Chairman Schapiro's leadership, the SEC will continue to review our report and take appropriate steps to implement our recommendations and ensure that fundamental changes are made in the SEC's leasing operations so the errors and failings we found in our investigation are remedied and not repeated in the future.

Conclusion

In conclusion, I appreciate the interest of the Chairman, the Ranking Member, and the Subcommittee in the SEC and my Office and, in particular, in the facts and circumstances pertinent to our leasing report. I believe that the Subcommittee's and

Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.

Testimony on the Lease of Constitution Center
by
Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission

Before the U.S. House of Representatives
Committee on Transportation and Infrastructure
Subcommittee on Economic Development, Public Buildings, and Emergency Management

July 6, 2011

Chairman Denham, Ranking Member Norton, Members of the Subcommittee:

Thank you for the opportunity to testify today regarding the Securities and Exchange Commission's lease of office space at the Constitution Center building in Washington, D.C.¹

Like the report of the Commission's Office of Inspector General (OIG) concerning Constitution Center, the Subcommittee's previous hearing identified a number of significant flaws in the SEC's leasing processes. The fact that the SEC has not paid any rent to date for this property and that the bulk of the space has been leased to other tenants does not adequately address a situation that never should have occurred. The only appropriate response by the SEC is to take all necessary steps to resolve the remaining space issues, to correct the obvious deficiencies in our leasing processes, to ensure accountability for the events surrounding this lease, and to work with the General Services Administration (GSA) with regard to future space needs.

¹ The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.

As Chairman of the SEC, I am ultimately responsible for the actions of the agency. I can assure you that the SEC will address the issues identified by the IG aggressively and transparently. As I have said previously, the true test of an organization is not whether things go wrong, but how the organization responds to problems and whether its leaders take such opportunities to make necessary improvements. My testimony today will outline for the Subcommittee how we have learned from these mistakes and how we intend to make certain that resources are spent prudently, that the agency implements the recommendations of the OIG, and that future leasing activity is managed properly.

I. Factual Background Leading To The OIG Report

The SEC currently employs approximately 3,900 permanent staff and more than 700 contractors. Approximately 60 percent of the permanent staff work out of the agency's headquarters, principally the Station Place buildings adjacent to Union Station in Washington, DC. The agency's remaining 1,500 employees (mainly enforcement and examination staff) work in our 11 regional offices. The SEC does not own any of its facilities, all of which are leased. In addition to office space, these leases include space for public meeting rooms, hearing and testimony rooms, files and records storage, and information technology (including the agency's data center and alternate data center). The SEC currently maintains about 2.5 million square feet of leased space. In the current fiscal year, the lease payments total approximately \$100 million, which is about 8 percent of the agency's annual budget. The Commission's Office of Administrative Services (OAS), through its Real Property and Leasing Branch, has been responsible for managing the leasing program for the agency.

In the Spring of 2010, the SEC anticipated the need not only to expand its longstanding core responsibilities but also to implement the substantial new obligations it was likely to be assigned under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Because these efforts would require the hiring of additional staff and space for expansion was limited under existing leases, OAS started to consider options for additional office space.

In June 2010, at a meeting regarding leasing issues with the then-Executive Director of the SEC as well as staff from OAS, I indicated my preference for hiring new staff in the regions rather than in headquarters, as well as my preference that new space in Washington be within walking distance of the Station Place buildings to eliminate the need for expensive shuttle services. With respect to Commission matters in which I am not an expert, I give overall policy goals and instructions – and I expect the professional staff to execute them consistent with my instructions.

Approximately one month later, on July 23, 2010, the then-Executive Director informed my staff that he urgently needed to discuss obtaining space at Constitution Center, a building located at 400 Seventh Street in southwest Washington, DC. I was told that our other leasing options in Washington, DC no longer existed, that the space at Constitution Center was our only option given our space needs, that the pricing was advantageous, and that we had to move quickly as there was competition for the space. Given our previous discussions, I assumed the proposal was consistent both with our budget projections for future employee growth and my preference for staff to be housed where possible in the regions, and concurred with the proposal. Shortly thereafter, on July 28, 2010, the SEC, through its leasing group, entered into an

agreement for 900,000 square feet at Constitution Center, with an ability to sublet the entirety of the space. The agreement was for a 10-year term, with the space to be delivered to the SEC in phases and the first space available at the start of fiscal year 2012 with rent payments to commence in January 2012.

Within weeks, I became increasingly concerned that the previously anticipated increase in funding for the SEC (both for existing programs and the new Dodd-Frank Act responsibilities) would not come to pass. The Continuing Resolution, which would ultimately remain in place for the first six months of fiscal year 2011, would limit the Commission's ability to hire new staff and thus limit our need for additional space. In light of these budgetary concerns, I met during the Fall of 2010 on multiple occasions with members of our leasing group to discuss options for Constitution Center that would limit the SEC's exposure for space it likely would not fill. The SEC worked with two non-appropriated financial regulatory agencies (the Office of the Comptroller of the Currency and the Federal Housing Finance Agency) that wanted to occupy the majority of the space allotted to the SEC (558,000 square feet). The SEC then released that space, permitting the landlord at Constitution Center to lease the space to these other federal tenants. The releases were conditioned on the SEC being released from all obligations for the 558,000 square feet. The other agencies entered into leases for the Constitution Center space in January 2011. As described in more detail below, the SEC has since been working with the GSA regarding the remaining space.

The SEC's Office of Inspector General recently reviewed the agency's leasing process for Constitution Center, issuing a report on May 16, 2011. The report provides a thorough

review of the OIG's findings and recommendations, and reveals significant flaws in our leasing processes. We are promptly implementing the OIG's recommendations, and, as described in more detail below, recently submitted to the OIG a written corrective action plan. Specifically, I have directed Jeff Heslop, the Chief Operating Officer to implement the OIG's recommendations and to address the deficiencies in our leasing processes. In addition, the employees recommended for possible disciplinary action by the OIG have been reassigned to other duties pending resolution of the disciplinary process, which we are moving forward on quickly.

II. The SEC's Obligations Regarding The Remaining Space At Constitution Center

As noted above, growing budget uncertainties led the SEC to seek ways to undo or limit the obligations imposed by the Constitution Center agreement. After successfully identifying two new lessees for the majority of the space, the SEC retains approximately 300,000 square feet at Constitution Center.

I recently met with the head of GSA to discuss, among other things, the remaining Constitution Center space. Both this and subsequent conversations between our staffs have gone well. GSA has informed us that it has prospective tenants with leasing needs that may align with the available Constitution Center space. More recently, Commission staff has been working to finalize the terms concerning the remaining space in order to move this process forward so that the space may be used by another federal tenant. We are urgently addressing any remaining issues regarding this lease, and will continue to work closely with GSA. Because of the timing of the lease, the SEC has not been required to make any lease payments to date.

III. The Inspector General's Recommendations

The Inspector General's report provides a thorough discussion of the OIG's findings and recommendations, and clearly reveals significant flaws in the process by which SEC leasing decisions were made. Last week, the SEC provided the IG with a written corrective action plan. While work is underway to implement the corrective actions described below, they may be revised or expanded as a result of the ongoing discussions with GSA. Currently the corrective action plan includes the following:

- Pending final resolution of the SEC's ongoing discussions with the GSA regarding the GSA's role in future leasing actions, as an interim action, I have revoked designations of authority that previously permitted the SEC to enter into real estate leases without my approval. Once an arrangement with GSA is reached -- which we contemplate will delegate to GSA all leasing activities on behalf of the SEC -- the agency will update any other delegations and designations of authority to ensure proper controls are in place.
- In response to the recommendation that the SEC conduct a comprehensive assessment of OAS operations, the SEC retained the services of outside consultants to assess OAS's organizational structure, including decision-making processes, reporting relationships, and quality controls.
- All leasing operations now report to the Chief Operating Officer.
- Creation of a senior executive-level facilities management oversight committee that will provide oversight and guidance to the SEC leasing process and will serve as a forum for executive-level discussion of the agency's leasing decisions.

- A review, led by the directors of our national enforcement and examination programs, of the SEC's regional office presence, which will include an assessment of the agency's location strategy and associated office space needs.
- Development of a new leasing project approval process that will address, among other things: coordination with GSA; estimation accuracy; the approval process for non-competitive leasing acquisitions; cost/benefit and business case analysis; funding availability; clear identification of hiring needs with the requisite geographic match; and external government agency requirements.

Although the SEC is engaged in the implementation of the corrective action plan, additional requirements and details are likely to be established consistent with the relationship established with GSA.

IV. The Commission's Leasing Efforts Going Forward

In light of the problems identified and questions raised by the OIG and this Subcommittee, the SEC recognizes the benefits of having GSA manage the Commission's future lease acquisitions. Leasing is not part of the Commission's core mission and we cannot allow it to impede that mission. GSA, by contrast, has long experience and expertise in leasing.

In my recent meeting at GSA, in addition to discussing the Constitution Center space, I discussed with the GSA Administrator ways in which GSA could assist the Commission on our leasing efforts going forward. GSA indicated it was open to playing a significant role in those efforts. Following my meeting, Commission staff has had further discussions with GSA staff, and recently drafted and provided to GSA a proposed Memorandum of Understanding (MOU).

It is my hope that we can have an agreement in place in short order. The MOU contemplates an immediate role for GSA in managing the upcoming SEC leasing activities concerning four leases coming due within the next year, as well as for all other future leasing needs as they arise.

Among other things, GSA would be responsible for assessing the space needs of the Commission including requirements development; planning for the acquisitions, including preparing preliminary cost estimates; drafting information lease prospectuses, conducting market surveys, and establishing negotiation goals and objectives; soliciting, receiving, assessing and negotiating the offers, which will cover the competition process; executing all required lease documents; and administering the lease, including responsibility for tenant improvements, construction, and any necessary moves. The anticipated arrangement with GSA will permit the SEC to pare down its leasing program solely to liaise with GSA. In addition to the leasing activities at the center of the MOU, we will be exploring other avenues of administrative services that GSA may be able to assist us with that will permit us to scale back further our administrative functions in the relevant areas. Until such time as the Commission and GSA are able to finalize the arrangement between GSA and the SEC, the SEC will not negotiate or enter into any lease renewals or new leases.

V. Status Of The Disciplinary Proceedings Recommended By The OIG

The OIG Report recommended that the SEC initiate disciplinary proceedings for three individuals involved in the Constitution Center leasing process. Accountability is critical because, without it, there is neither fairness nor reform.

We have begun that disciplinary process. Specifically, the Office of General Counsel is actively reviewing the record from the OIG investigation and, where necessary, supplementing

the OIG's investigation, analyzing documents and conducting relevant interviews. I have instructed my staff to move as quickly as the laws and regulations permit, consistent with fundamental fairness, to assess and implement remedial measures and discipline as appropriate. I expect that disciplinary recommendations with regard to employees identified in the OIG Report will be made as soon as possible. In the meantime, the individuals identified in the OIG report have been reassigned. Their current duties do not involve leasing or any other authority that could bind the Commission, nor do they involve duties that relate to the expenditure of appropriated funds.

VI. Conclusion

There is no doubt that the OIG Report and the Subcommittee's most recent hearing identified substantial failures in the SEC's leasing process, and I am making every effort to address those failures and ensure against them in the future. These efforts include items specific to Constitution Center, including actions to eliminate the remaining space obligations and to conduct the disciplinary process for the relevant individuals. In addition, we are moving quickly to make more programmatic reforms that will incorporate GSA into our future SEC leasing needs.

I would be happy to answer any questions you may have.



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

August 23, 2011

The Honorable Jeff Denham
Chairman
Committee on Transportation and Infrastructure
Subcommittee on Economic Development, Public Buildings,
and Emergency Management
589 Ford House Office Building
Washington, DC 20515

Dear Chairman Denham:

Attached please find a transcript copy from the July 6, 2011 Subcommittee on Economic Development, Public Buildings, and Emergency Management hearing with my corrections included. I tried to answer the Subcommittee's questions on the various subjects to the best of my recollection.

In addition, I wanted to clarify certain information on transcript page 25, lines 556 to 566. First, the need for additional space was not based upon the hiring underway in FY 2010, but rather based on the agency's FY 2011 and FY 2012 requests, as well as the new responsibilities the agency expected to receive from what became the Dodd-Frank Act. Second, although the Dodd-Frank Act greatly increased the need for additional resources, the agency did not formally amend the President's Request for FY 2011.

If there are any other issues that the Subcommittee would like me to clarify, I would be happy to supplement the record. I respectfully request that a copy of this transmittal letter be made a part of the hearing record.

If you have any questions, please do not hesitate to contact me at (202) 551-2100 or have your staff contact Tim Henseler, Deputy Director of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,

Handwritten signature of Mary L. Schapiro in cursive.

Mary L. Schapiro
Chairman

where we locate most of our examination and enforcement staff, which are the two largest parts of the SEC.

Mr. DENHAM. The 2010 budget you established a need for how many employees?

Ms. SCHAPIRO. In the 2010 budget—let me give you the exact number—550.

Mr. DENHAM. Out of those 550, how many were you looking at having walking distance from the current SEC building and how many were you looking at having in the region?

Ms. SCHAPIRO. To the extent possible, we were going to put the 550 in our existing headquarters space and utilize all of that space and then some number—I'm sorry, I have to get you an exact number—to go out to the regional offices.

Mr. DENHAM. I'm just trying to get a ball park and better understand the timeline. How much space do you currently have at your current location?

Ms. SCHAPIRO. About 380 in DC and 170 out to the regions.

Mr. DENHAM. And how much space do you have currently?

Ms. SCHAPIRO. I'm told that currently we have space, I believe, for about 500 in Station Place in our existing headquarters building.

Mr. DENHAM. So you could have accommodated the entire 380 that you wanted to keep in DC at your current location.

Ms. SCHAPIRO. Yes, but I was told in June of last year that we had no space left in Station Place at all.

Mr. DENHAM. Is that where your office is?

Ms. SCHAPIRO. Yes.

Mr. DENHAM. And when did it become apparent you were going to need additional space beyond what you had originally estimated under the 2010 budget, the 550 new personnel?

Ms. SCHAPIRO. Well, as we—based on our fiscal year 2011 request—and I understand that's a request, not an appropriation—as well as the new work that was being assigned to the Agency under Dodd-Frank, it became clear in the late spring that we would need—and into the summer and certainly by the middle of the summer after Dodd-Frank passed—that we would need significant additional resources to fulfill our responsibilities under Dodd-Frank.

Mr. DENHAM. OK. Let me see if I can walk through this timeline as I understand it.

Spring, you decided you were going to need new space under the 2010 budget. June, you started having meetings. And then you saw the Dodd-Frank bill starting to get rolled out in committee—I'm paraphrasing that a little bit—saw the Dodd-Frank bill being rolled out in committee. You had your fiscal year 2011 request in at the time and then expanded that request based on the Dodd-Frank legislation which was going to pass a month later.

Ms. SCHAPIRO. Yes.

Mr. DENHAM. And based on what you thought the Dodd-Frank bill that was going to get passed on July 21st, based on that bill, how many additional employees did you feel you were going to need on top of the 550 that you already had budgeted?