



September 15, 2006

Brooks H. Browne
Chairman of the Audit Committee
Allied Capital
1919 Pennsylvania Avenue, NW
Washington, DC 20006-3434:

Dear Mr. Browne:

On March 11, 2005, I wrote to you concerning the continuing misconduct of Allied Capital's management. I provided detailed specifics concerning several aspects of the fraud being perpetrated by management against both the public and the government, including: (1) management's scheme to maintain an artificially high valuation of its small-business lending unit, Business Loan Express ("BLX") by defrauding the Small Business Administration; (2) management's misrepresentations to public concerning the performance of Allied and BLX; and (3) illegal attempts to access my confidential, personal information (a technique called "pretexting") by individuals who likely acted at the direction of, or had some connection to, Allied management. As you are well aware, all of these aspects of management conduct are currently under investigation by the Department of Justice and the SEC.

Your response to my March 11 letter contained no specific information and simply said that the information received from management and outside counsel did not support any of the accusations of misconduct. You did not specifically address the "pretexting" issue.

However, recent public events have made clear the degree to which the Board has underestimated the seriousness – and criminal nature – of the conduct described in my earlier letter, including the "pretexting" issue. I therefore write again in the hopes that the Board will now take these issues more seriously.

Regarding pretexting: as the news media has recently reported, Hewlett-Packard's former chairwoman, Patricia Dunn, in an apparent effort to discover the source of boardroom leaks to the media, employed investigators who in turn illegally accessed the phone records of both members of HP's board and reporters for various news organizations who had published articles critical of HP. The methods employed by the investigators hired by Ms. Dunn were essentially identical to the methods used to access my own telephone records. As several news organizations have reported, the contractor falsely used individuals' names, telephone numbers and social security numbers to illegally access their phone records online. This is precisely the manner in which my own records – and the records of several notable Allied critics – were accessed.

As the investigations into HP's conduct plainly demonstrate, illegally accessing an individual's confidential records constitutes criminal conduct. The repercussions to HP

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for use of this technique have gone far beyond mere embarrassment to the company. Ms. Dunn has already resigned. Congress, federal and state prosecutorial and investigatory agencies have all initiated investigations into HP's use of pretexting. The Attorney General of California, Bill Lockyer, has indicated that he has sufficient information to indict several individuals, both within and outside HP.

The only group of individuals with any motive to access my phone records and the records of four other prominent Allied critics is Allied management. In light of the public outcry and potential criminal indictments resulting from HP's conduct, the Board cannot pretend that such use of pretexting is not a serious matter. Indeed, the pretexting in this case does not merely concern leaks, but is far more serious. If Allied management was involved in illegally accessing the phone records of its critics, such pretexting constitutes an attempt by a company to interfere with and chill its critics and therefore skew the flow of information which is critical to the securities markets. The Board clearly has an obligation to investigate such potential criminal conduct by Allied's management.

In short, the Board owes a fiduciary duty to Allied and its shareholders to conduct a thorough investigation to determine whether in fact Allied management was involved in any way in the pretexting scheme. If criminal conduct was committed, appropriate steps must be taken including but not limited to reporting that conduct. I will be happy to provide the Board with any additional information that will be of assistance in such an investigation, subject to any restrictions placed on such information by governmental agencies currently investigating the same matter. If you deny that Allied management or its agents were involved in any way in pretexting or accessing my telephone records then please confirm that fact for me; otherwise, I will assume that the clear inference that Allied management engaged in this illegal conduct is in fact true.

Yours,



David Einhorn

