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November 6, 2007

VIA FACSIMILE AND E-MAIL

Bruce W. Sanford, Esq.  
Baker & Hostetler LLP  
Washington Square, Suite 1100  
1050 Connecticut Avenue, N.W.  
Washington, D.C. 20036-5304

**Re: Allied Capital Corporation**

Dear Mr. Sanford:

Thank you for your letter of October 31, 2007. Although our letter of October 5, 2007 was apparently forwarded to you, you do not ever address our offer to meet with Allied management to offer those individuals the opportunity to respond to Mr. Einhorn's questions about Allied. Since those questions will clearly touch on the areas of Allied's business of which Mr. Einhorn has been critical, it seems to address exactly what you say Allied has been trying to address indirectly with John Wiley & Sons ("Wiley"). You say:

Allied Capital has offered over the last six months to meet with editors from Wiley to answer any questions and address any concerns they may have regarding statements about Allied in Mr. Einhorn's manuscript. It would also present the opportunity to provide Wiley the full picture regarding Allied's business, including how the public, the courts, the markets, and others have concluded that Mr. Einhorn's charges against Allied are not valid.

While we are not aware that Wiley has expressed a need for such assistance from you, Mr. Einhorn stands ready to ask the questions you say Allied will answer, express the concerns you say Allied will address and hear Allied's views on its business which you say Allied is willing to present. This is of course the appropriate way to address your concerns since Mr. Einhorn is the author who will ultimately determine the text of the book and who has the expertise in these issues. Please let us know if you want to have such a meeting.

As to some of your other points, we simply do not agree. We are not aware that anyone has concluded that Mr. Einhorn's charges, as you call them, are not valid.

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To the contrary, as time goes by, it seems Mr. Einhorn's charges are repeatedly substantiated. For example, the indictment and guilty plea of a BLX executive, Patrick Harrington, corroborated the very fraudulent loan practices which Mr. Einhorn had long said infected BLX, and which Allied had denied existed. The Michigan office in which Mr. Harrington worked, apparently an engine of loan fraud, is now closed down. In that same vein, the OIG of the SBA has recently issued a report, which although heavily redacted, appears also to criticize BLX's abusive loan practices on a broader scale. BLX apparently relied on the government's guarantees to backstop loans that should never have been made but which benefited Allied's bottom line. Mr. Einhorn had also been critical of Allied's valuations of securities in its private finance portfolio. The SEC agreed, finding that the documentation and controls regarding valuation of numerous investments in Allied's portfolio were woefully deficient. The SEC's finding aligned with Mr. Einhorn's long-held view that the valuations were inflated. As a result, the SEC found that Allied violated the Securities Exchange Act of 1934 and imposed a cease and desist order on the company. Finally, Allied also denied that Mr. Einhorn had been pretexted and claimed that Mr. Einhorn had fabricated that issue to damage the company. In December 2006, Allied was subpoenaed on this issue and only then, in February 2007, did it come clean and admit that Mr. Einhorn had been pretexted by the company's agents. Therefore, it is not clear who has concluded that Mr. Einhorn's charges have been incorrect, but that group cannot include the Department of Justice, the SEC, the OIG of the SBA or the public and journalists who have seen Mr. Einhorn proven correct time and again.

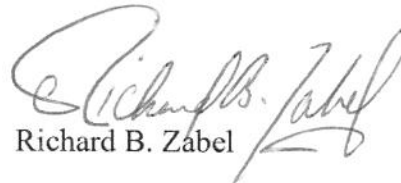
Your comment about "cheap shots" appears directed at Mr. Einhorn and it is categorically untrue. Every single thing that Mr. Einhorn has said about BLX or Allied has been supported by facts, data and analysis. To the contrary, it is Allied who has tried to brand Mr. Einhorn as a manipulator of Allied's stock price, simply trying to make a fast profit. By now, after five years, it should be evident how wrong that view is and how deeply Mr. Einhorn believes that your clients are engaged in a fraud. Your complaints about his not being "disinterested" and having a "financial incentive" to drive down Allied's stock have no weight. And if they did, then your clients are equally to be disbelieved since they are not disinterested and have every reason to say whatever will perpetuate their scheme.

Clearly, you are not going to be provided Mr. Einhorn's manuscript and you know that. Allied can, if it wants, sit down with Mr. Einhorn and respond on these issues.

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Nor is Regulation FD, to which you refer, an impediment, unless Allied wants it to be. Regulation FD does not “restrict[] a company from sharing material non-public information with a member of the investing public” unless the company does not want to disclose that information to the rest of the investing public. If you have good explanations for Mr. Einhorn’s criticisms and answers to his questions, which you claim to have, why wouldn’t you want to share that with the entire investing public?

Sincerely,



Richard B. Zabel

cc: David Einhorn  
Deirdre Silver