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White Collar Watch

An eye on whistleblowers, false claims and compliance

Saul Ewing LLP

White Collar and Government Enforcement Practice

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Federal court unseals rare False Claims Act complaint against home mortgage servicer

By Aaron J. Kornblith

IN BRIEF

- **The complaint claims lender OneWest falsely certified that it made required disclosures to homeowners, leading the federal government to pay more than $200 million in false claims.**
- **OneWest acquired its loan portfolio from the failed IndyMac Bank, which collapsed amid the financial crisis in 2008.**

The U.S. District Court for the Southern District of New York recently unsealed a complaint filed against lender OneWest Bank FSB ("OneWest") by a whistleblower, marking a rare False Claims Act ("FCA") case brought in the financial services sector.

The complaint in *United States ex rel Fisher v. OneWest Bank FSB*, No. 12-09352 (S.D.N.Y.) alleges that OneWest repeatedly falsely certified that it would, or did make, required disclosures to consumers in connection with its participation in the Home Affordable Modification Program ("HAMP"). The complaint alleges that OneWest's resulting fraudulent claims caused the government to pay more than $200 million.

OneWest got its start in 2009 with its acquisition from the Federal Deposit Insurance Corporation ("FDIC") of IndyMac Bank FSB ("IndyMac"). IndyMac was seized by the FDIC in July 2008 after it failed due to its enormous portfolio of underperforming mortgages. IndyMac's assets – approximately $32 billion – made it one of the largest bank failures in U.S. history.

After acquiring IndyMac, OneWest agreed in September 2010 to participate as a servicer for HAMP, a role it continues today. HAMP was instituted by the Obama administration in 2009, with the goal of preventing struggling borrowers from defaulting on their home mortgages. Under the program, servicers and other parties involved in loans secured by homes receive financial incentives from the government in return for modifying the terms of the loans to keep borrowers out of default. Like other HAMP servicers, OneWest agreed that it would make all required disclosures to borrowers under laws such as the Truth in Lending

Act ("TILA"), and it periodically certified that it had in fact made these disclosures.

The complaint alleges that OneWest "typically failed to disclose anywhere in the modification agreements" various terms such as the finance charge, the annual percentage rate, or the total amount of payments. Further, it claims OneWest "virtually always" added new debt to the borrower's balance, averaging about $17,000 per contract. This was allegedly done without any itemizations or disclosures that would have revealed the actions taken. By modifying loans without making the necessary TILA disclosures, while at the same time certifying that it had made these disclosures and accepting government incentives, OneWest allegedly made false claims under the FCA that caused the government to pay out over $206 million. Of this total, more than $58 million went directly to OneWest as the servicer for the loans.

The *qui tam* complaint was brought by Michael J. Fisher, a former employee of two law firms in California and Texas whose clients sought loan modifications from OneWest and other servicers. The case was unsealed after the federal government declined its option under the FCA to intervene in the action.

Qui tam relators target – and gain access to – internal investigation on ground that attorney-client privilege does not apply

By Christopher R. Hall and Matthew J. Smith

IN BRIEF

- **A federal district court recently held that documents relating to a government contractor's internal compliance investigations regarding fraud were not protected by the attorney-client privilege because the investigations were undertaken to comply with regulations and corporate policy rather than to obtain legal advice.**
- **If upheld, this decision will present pitfalls to companies which conduct internal reviews at the direction of regulatory authorities or pursuant to a statutory mandate.**
- **Companies should involve counsel in each step of internal investigations and expressly articulate and document the legal purpose of the investigation at every phase.**

In an unsettling rejection of the attorney-client privilege, a judge for the U.S. District Court for the District of Columbia ruled last month that documents pertaining to a company's mandatory, internal, compliance investigations – conducted mainly by non-attorneys and forwarded to the company's legal department – were not protected by the attorney-client or attorney work-product privileges. This case raises important questions for an array of regulated companies with mandated reporting obligations whose internal investigations could be left unprotected. *United States ex rel. Barko v. Halliburton Co. et al.*, No. 1:05-cv-1276 (D.D.C. Mar. 6, 2014). See http://www.crowell.com/files/US-ex-rel-Barko-v-Halliburton-Co.pdf for the full decision.

Background

The case involves a *qui tam* action in which the defendants, including private military contractor Kellogg Brown & Root Services, Inc. ("KBR"), allegedly violated the False Claims Act ("FCA") through improper bidding and billing practices for subcontract work invoiced to the U.S. military. The relator moved to compel the production of documents relating to KBR's internal Code of Business Conduct ("COBC") investigations of the matter. After conducting an *in camera* review, District Court Judge James Gwin held that the documents were not protected by the attorney-client or work-product privileges.

Attorney-Client Privilege

For the attorney-client privilege to apply, KBR had to show that the communications were made *primarily* for the purpose of securing legal advice or services. To determine the primary purpose of the communications, the court applied the "but for" test – meaning the court inquired whether the communications would not have been made "'but for' the fact that legal advice was sought."

The court denied the attorney-client privilege because KBR's internal investigations "were undertaken pursuant to regulatory law and corporate policy rather than for the purpose of obtaining legal advice." As the court explained, "Department of Defense contracting regulations require contractors to have internal control systems such as KBR's COBC program to '[f]acilitate timely discovery and disclosure of improper conduct in connection with Government contracts.'" KBR's COBC policies, the court concluded, "merely implement[ed] these regulatory requirements." Accordingly, the court held that the investigative materials did not pass the "but for" test because the "investigations resulted from [KBR's] need to comply with government regulations" and would have been conducted "regardless of whether legal advice [was] sought."

The court reasoned that employees who were interviewed during the investigations "were never informed that the purpose of the interview was to assist KBR in obtaining legal advice," nor was that purpose mentioned in the confidentiality agreements signed by employees. Additionally, a non-attorney conducted the interviews, and therefore the interviewees could not infer the "legal nature of the inquiry."

Attorney Work-Product

The court also held that the attorney work-product doctrine did not apply because the internal investigations were conducted "in the ordinary course of business irrespective of the prospect of litigation," and "government regulations required KBR to investigate potential fraud." The fact that the investigations took place several years before the lawsuit was unsealed further supported the court's view, as did the fact that non-attorneys primarily conducted the investigations.

Takeaway

If upheld on appeal, the District of Columbia's opinion would set a dangerous precedent. Internal investigations by regulated companies, especially those with mandatory investigation and disclosure obligations, would not enjoy privilege protection unless carefully conducted. Because mandatory compliance programs and internal controls are becoming standard in many industries, the effect would reach far beyond just government contractors. For instance, publicly traded companies subject to the Sarbanes-Oxley Act are required to maintain a system of internal controls and a mechanism for internal investigations, and health care companies are required to maintain compliance programs under the Patient Protection and Affordable Care Act.

Whistleblower retaliation exposes Playboy to $6 million liability

By Nicholas C. Stewart

A federal jury recently ordered Playboy Enterprises to pay $6 million to a former accounting executive who was wrongfully terminated in retaliation for blowing the whistle internally on what she perceived was improper executive compensation. The executive-turned-whistleblower, Catherine Zulfer, learned that the CEO and CFO intended to pay themselves $1 million in bonuses without first obtaining board approval. Zulfer reported her concerns internally to Playboy's general counsel and outside Securities and Exchange Commission counsel.

The company's CFO – to whom Zulfer reported directly – did not respond well. The jury's verdict suggests he stopped communicating with her, excluded her from meetings, and

increased her workload. The CFO also implemented a plan to terminate employees who had been with the company for more than 10 years. Playboy terminated Zulfer about a year later, despite positive reviews over her 30-year career at the company.

Zulfer filed a whistleblower lawsuit for violations of the Sarbanes-Oxley Act, 18 U.S.C. § 1514A, *et seq.*, and for age discrimination. The California jury returned a verdict for Zulfer and awarded her a $6 million judgment. As part of an undisclosed settlement agreement, Zulfer voluntarily dismissed her claims for punitive damages, even though the jury found that Playboy acted with malice.

This case serves to remind companies of the importance of taking employee concerns seriously and treating workers fairly when they have the courage to report concerns internally. Companies who adopt best practices encourage internal whistleblowing. They investigate employee concerns, report back to the whistleblower to the extent possible (given competing confidentiality obligations), and avoid human resources moves which might be perceived as retaliation.

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