JONES DAY

JUNE 2016

COMMENTARY

Texas Federal Court Declines to Apply State Law Privilege in False Claims Act Case

The Eastern District of Texas reminded practitioners that it is an uphill battle to use a state law privilege as a shield in *qui tam* False Claims Act cases. The court held that West Virginia's statutory bank examiner privilege did not apply to documents related to West Virginia's investigation of Ocwen Loan Servicing LLC's lending practices, meaning that documents inadvertently produced by Ocwen in the federal proceeding arising from the state investigation were not privileged and could be used at trial. *United States ex rel. Fisher v. Ocwen Loan Servicing, LLC*, No. 4:12-CV-543, 2016 WL 3172774, at *5 (E.D. Tex. June 7, 2016).

Background–FRE 501 and the West Virginia Bank Examiner Privilege

Under Federal Rule of Evidence 501, federal common law governs a claim of privilege in federal question cases. However, when a case involves a privilege "not existent in the [federal] common law but enacted by the (state) legislature based upon unique considerations of government policy," the state law privilege may be applied in a federal question case after "balancing the policies behind the privilege against the policies favoring disclosure." *Am. Civil Liberties Union v. Finch*, 638 F.2d 1336, 1343 (5th Cir. Unit A 1981).

The balancing test involves two questions: "(1) whether the fact that the [state] courts would recognize the privilege itself creates good reason for respecting privilege in federal court, regardless of our independent judgment of its intrinsic desirability; and (2) whether the privilege is intrinsically meritorious in our independent judgment." *Id.*

The answer to the first question is almost always no because "[t]hat the courts of a particular state would recognize a given privilege will not often itself justify a federal court in applying that privilege." *Fairchild v. Liberty Indep. Sch. Dist.*, 466 F. Supp. 2d 817, 821 (E.D. Tex. 2006). As to the second question, the court applies four factors: "(1) whether the communications originated in a confidence that they will not be disclosed; (2) whether confidentiality is essential to the full and satisfactory maintenance of the relation between the parties; (3) whether the relation is one in which the opinion of the community ought to be sedulously fostered; and (4) whether the injury that would

inure to the relation by the disclosure of the communications is greater than the benefit gained for the correct disposal of the litigation." *Ocwen*, 2015 WL 3172774, at *4.

Here, West Virginia provides for a statutory bank examiner privilege: "[T]he records relating to the financial condition of any financial institution and any information contained in the records shall be confidential…. No person shall divulge any information contained in any records except as authorized in this subdivision in response to a valid subpoena or subpoena duces tecum issued pursuant to law in a criminal proceeding or in a civil enforcement action brought by the state or federal regulatory authorities." West Virginia Code § 31A-2-4(b)(1). The general purpose is to encourage cooperation and compliance with the regulatory process and facilitate the open exchange of information between financial institutions and their regulators. *See Ocwen*, 2015 WL 3172774, at *2.

Facts of the Case

Relators alleged that Ocwen's loan servicing, modifications, and loss mitigation practices failed to comply with state and federal law, contrary to Ocwen's certifications that they did comply. *Id.* at *1. Relators specifically claimed that the West Virginia Division of Financial Institutions' ("WVDFI") findings were relevant to the alleged false representations made by Ocwen. *Id.*

WVDFI is a state regulatory agency responsible for the oversight of West Virginia's financial services industry, which communicated with and investigated Ocwen. WVDFI issued reports identifying Ocwen's violations of West Virginia law and assessed nearly $2 million in civil penalties against Ocwen. *Id.* In addition to the direct communications between WVDFI and Ocwen, Ocwen also had internal communications and generated internal documents related to those discussions. *Id.* at *2.

Ocwen produced a WVDFI report, which the relators then used as an exhibit to their motion for summary judgment in December 2015. One month later, Ocwen informed the relators that it had completed its privilege analysis and that it had intended to withhold all reports and communications with the WVDFI pending WVDFI's response to Ocwen's consent for disclosure. Simultaneously, Ocwen requested such consent from WVDFI. *Id.*

In May 2016, WVDFI informed Ocwen that it *did not consent* to the disclosure and stated that it considered protecting such information to be an important public policy of the state. *Id.* (WVFI specifically stated "[the statute] provides clear and unequivocal codification of an important multifaceted public policy, as confidentiality of the subject information … encourages cooperation and compliance with the regulatory process and facilitates the open and unfettered exchange of information"). Accordingly, Ocwen requested that the relators destroy the inadvertently produced WVDFI documents under the Agreed Clawback Order, which mirrored Federal Rule of Civil Procedure 26(b)(5)(B). The relators then filed their Emergency Motion for Privilege Determination, arguing that Ocwen's attempt to claw back the documents had no basis in case law or statute and that the documents were discoverable. *Id.* at *2-3.

Court's Analysis

The court applied the *Finch* balancing test to determine whether the privilege applied. *Id.* at *3-5.

With regard to the first question—whether the fact that the state court would recognize the privilege creates a good reason for respecting the privilege in federal court—the court found it did not because of the "strong federal interest in FCA cases for seeking the truth" and because federal law plays a predominant role in the litigation. *Id.* at *4.

With regard to the four factors pertinent to determining whether the privilege is intrinsically meritorious, the court focused on the first factor—whether the communications originated in a confidence that they would not be disclosed. While the court found that the communications between WVDFI and Ocwen indicated that they expected confidentiality and that the communications would not be disclosed under state law, the court nevertheless concluded that this factor weighed in favor of disclosure. *Id.* at *4-5. This is because the statute provides an exception allowing disclosure in civil enforcement actions brought by state or federal authorities. While this case was not brought by federal authorities and the government declined to intervene, the relators stood in the shoes of the government. The court found the documents did not originate in confidence because WVDFI should not have assumed their documents would be protected in an FCA action. *Id.* at *5. And, despite WVDFI not consenting to

the agreed disclosure (and at least implicitly maintaining the information should not be disclosed), the court found that, on balance, the factors favored disclosure. *Id.* (finding WVDFI's ability to require cooperation would not be impaired by disclosure and, because factors one and two weighed in favor of disclosure, the balance weighed in favor of disclosure for the benefit gained by seeking the truth).

The court found that neither the communications between Ocwen and WVDFI, nor Ocwen's internal communications, were privileged and that the relators could use them at trial.

Practical Implications

The *Ocwen* decision has at least two important implications: It remains an uphill battle to have a state law privilege recognized in federal question cases, and this is true even where a state agency maintains that such materials should not be disclosed and advocates for protection. Courts may sometimes elevate a perceived need for disclosure over a state law privilege, which can be a broad sword for relators.

On the defensive side, the case serves as another reminder of the need to think through the implications of state investigations on future litigation, including what may or may not remain privileged. Planning and open discussions may help companies determine how and in what manner materials may be used in the future. Before the creation of documents, careful analysis should be given as to what privileges may apply and how to preserve any privileges at that time, and careful consideration should also be given before the production of any such documents.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

J. Laurens Wilkes
Houston
+1.832.239.3796
jlwilkes@jonesday.com

Joshua L. Fuchs
Houston
+1.832.239.3719
jlfuchs@jonesday.com

Jane W. Walker
Houston
+1.832.239.3758
jwwalker@jonesday.com