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Challenging FIRREA Subpoenas: The RMBS Working Group Faces Subpoena Fight



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Introduction

As the Justice Department has stepped up its pursuit of financial institutions, there has been a surge of civil fraud lawsuits brought by the government under FIRREA — the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 — a law that allows the government to sue for civil penalties for fraudulent conduct affecting federally insured financial institutions.[1] FIRREA has been used as the basis for investigations and fraud lawsuits against banks and mortgage lenders in a variety of contexts, including the rating and sale of residential mortgage backed securities (RMBS),[2] government loan originations,[3] conventional loan sales to Fannie Mae and Freddie Mac,[4] and the supervision of payment processors.[5] Using FIRREA, the government has obtained sizable settlements,[6] prevailed in several recent court challenges to the government's expansive use of FIRREA,[7] and most recently

[1] 18 U.S.C. § 1833a.

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[2] *United States v. McGraw Hill Cos., Inc.*, C.D. Cal., No. 13-799, 7/16/13, http://www.bloomberglaw.com/public/document/United_States_of_America_v_McGrawHill_Companies_Inc_et_al_Docket_/4; *United States v. Bank of America Corp.*, W.D.N.C., No. 13 Civ. 446, 8/6/13.

[3] *United States v. CitiMortgage, Inc.*, 11 Civ. 5473 (S.D.N.Y.).

[4] *United States ex rel. O'Donnell v. Countrywide Fin. Corp.*, S.D.N.Y., No. 12 Civ. 1422, 8/16/13, http://www.bloomberglaw.com/public/document/United_States_v_Countrywide_Fin_Corp_No_12_Civ_1422_JSR_2013_BL_2.

[5] *United States v. First Bank of Del.*, 12 Civ. 6500 (E.D. Pa.).

[6] *See, e.g.*, *United States v. CitiMortgage, Inc.*, No. 11 Civ. 5473 (S.D.N.Y.); *United States v. First Bank of Del.*, No. 12 Civ. 6500 (E.D. Pa.).

[7] *See United States v. Wells Fargo Bank, N.A.*, S.D.N.Y., No. 12 Civ. 7527, 9/24/13, http://www.bloomberglaw.com/public/document/United_States_of_America_v_Wells_Fargo_Bank_NA_Docket_No_112cv075/3; *United States ex rel. O'Donnell v. Countrywide Fin. Corp.*, S.D.N.Y., No. 12 Civ. 1422, 8/16/13; *United States v. Bank of N.Y. Mellon*, No. 11 Civ. 6969, 2013 (S.D.N.Y. Apr. 24, 2013).

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obtained a jury verdict in the first FIRREA case against a significant financial institution to go to trial.[8] Its statute of limitations reaches back ten years, and thus exposes to scrutiny actions the Justice Department perceives as contributing to the 2007 financial crisis.

Not surprisingly, in light of this surge of FIRREA enforcement, more and more financial institutions are finding themselves on the receiving end of FIRREA subpoenas, both from the Justice Department in Washington, D.C., and from U.S. Attorney's offices around the nation. While FIRREA subpoenas are no longer a rarity, court challenges to FIRREA subpoenas — like challenges to most subpoenas issued by law enforcement agencies — still are. The prevailing wisdom has long been that challenging a government subpoena has no upside and poses great risk: Such challenges, the thinking goes, are rarely successful, and bringing a challenge risks incurring the wrath of the prosecutor, who may only become more aggressive, thinking the company has something to hide. What is more, when you file a court challenge to a subpoena, you immediately make public the previously confidential fact that the government is investigating you.

Suiting Up: The First Battle

Recently, however, one company bucked the prevailing wisdom, drawing itself into an unprecedented court battle with the Justice Department's RMBS Working Group over the enforcement of a FIRREA subpoena. In July 2013, that Working Group issued a FIRREA subpoena to Clayton Holdings, LLC, a due diligence firm, in connection with the government's ''nationwide investigation into the assembly, underwriting, and issuance of residential mortgage-backed securities during the time period between 2005 and 2007.''[9] Clayton is not the target of the investigation, as the government is reportedly investigating 15 financial institutions that used Clayton's due diligence services. The government's subpoena is not limited to those 15 institutions, however. Rather, it broadly seeks ''all data'' from ''any database'' concerning the company's provision of due diligence services on mortgage loans and mortgage pools in the relevant time period, as well as all emails and other communications regarding those due diligence services.[10] When Clayton and the government failed to reach an agreement on compliance with the subpoena, the government took Clayton to federal court, bringing an enforcement action against Clayton in the District of Connecticut.[11]

Clayton did not challenge the government's authority to issue the FIRREA subpoena. Rather, it focused its challenge on the scope of the subpoena and the burden it would impose on Clayton. Clayton argued that the government's broad subpoena for ''all data,'' for *all* of its due diligence clients, amounted to an impermissible ''fishing expedition'' because the government had already acknowledged that it was not investigating all of Clayton's 193 clients, but rather only 15 of them.[12] According to Clayton, it had cooperated with various government agencies in multiple investigations for more than six years, but the government was no longer satisfied to seek documents for specific investigations; instead, it now wanted to establish a ''repository'' of all of Clayton's due diligence documents.[13]

In response to Clayton's challenge, the government argued that the subpoena's broad scope was permissible because the government's investigation into RMBS fraud was itself broad. And in response to Clayton's argument that the burden of production was too heavy, the government ''offered'' to ''assist'' Clayton with its production by ''mirror[ing] Clayton's servers,''[14] thereby relieving Clayton of any burden. Further, in response to Clayton's claim that document review would be costly, the government argued that a manual, pre-production document review by Clayton was not necessary because the government would agree to return to Clayton any privileged or irrelevant material produced.[15]

An Uphill Battle: The Law Governing Administrative Subpoenas

The government may have been emboldened to take such aggressive positions against Clayton because the law governing challenges to administrative subpoenas favors the government, and FIRREA subpoenas arguably qualify as administrative subpoenas. While ''the district court's role is not that of a mere rubber stamp''[16] the requirements for subpoena enforcement are nonetheless ''minimal.''[17] Generally, a court will enforce an administrative subpoena if: (1) The issuing agency has the authority to issue the subpoena, (2) the subpoenaed information is ''reasonably relevant'' to the government's investigation, (3) the subpoena is not unreasonably broad or burdensome, and (4) the government does not already possess the subpoenaed information.[18] Each factor is discussed briefly below.

The Agency's Authority

Claims that the government lacked authority to issue the subpoena (a challenge Clayton did not raise) have met with mixed success. The leading case on this point is *Burlington Northern Railroad Co. v. Office of Inspector General*. In that case, the Inspector General of the Railroad Retirement Board issued a subpoena as part of

[8] *See United States ex rel. O'Donnell v. Countrywide Fin. Corp.*, No. 12 Civ. 1422 (S.D.N.Y.).

[9] *United States v. Clayton Holdings, LLC*, No. 13 Civ. 116 (D. Conn. Aug. 27, 2013) (Memorandum In Support of Motion for Rule to Show Cause (''Government's Br.'') at 2).

[10] Government's Br. Ex. A (Subpoena Duces Tecum for the Production of Documents).

[11] *United States v. Clayton Holdings, LLC*, No. 13 Civ. 116 (D. Conn. Aug. 27, 2013).

[12] *United States v. Clayton Holdings, LLC*, No. 13 Civ. 116 (D. Conn. Sept. 24, 2013) (Respondent's Memorandum of Law in Opposition to Government's Motion to Compel Production of Documents From Third Party Witness Clayton Holdings LLC (''Respondent's Br.'') at 9).

[13] *Id.*

[14] Government's Br. at 4.

[15] *Id.*

[16] *Wearly v. Fed. Trade Comm'n*, 616 F.2d 662, 665 (3d Cir. 1980); *see also United States v. Sec. State Bank & Trust*, 473 F.2d 638, 642 (5th Cir. 1973) (''The system of judicial enforcement is designed to provide a meaningful day in court for one resisting an administrative subpoena.'').

[17] *See Burlington N. R.R. Co. v. Office of Inspector Gen.*, 983 F.2d 631, 637 (5th Cir. 1993).

[18] *See United States v. Powell*, 379 U.S. 48, 57–58 (1964); *United States v. Morton Salt Co.*, 338 U.S. 632, 652–53 (1950); *Doe v. United States*, 253 F.3d 256, 263–65 (6th Cir. 2001); *Fed. Trade Comm'n v. Texaco*, 555 F.2d 862, 871–72, 881–82 (D.C. Cir. 1977).

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an audit of a railroad company. The Fifth Circuit denied enforcement of the subpoena, finding that the Inspector General's audit was outside of the scope of its statutory authority.[19] Several courts have disagreed with that decision, however, arguably undercutting its precedential weight.[20] The weight of this contrary authority makes challenges to the government's right to issue a subpoena less likely to succeed.

'Reasonable Relevance'

Challenges based on relevance also have proven difficult. In subpoena enforcement cases, courts have construed ''reasonable relevance'' broadly, requiring only that the information sought not be '' 'plainly incompetent or irrelevant to any lawful purpose' of the agency.''[21] Indeed, some courts have held that a court should accept an agency's relevancy determination, unless that determination is ''obviously wrong.''[22] In the Clayton case, the government brushed aside objections based on relevance, citing FIRREA's provision authorizing the government to subpoena documents ''which the Attorney General deems relevant or material to the inquiry,'' 12 U.S.C. § 1833(a)(g)(1).[23] According to the government, therefore, the question of whether the requested documents are relevant to the inquiry is answered by the very fact that the government requested them.

Scope and Burden

Companies challenging government subpoenas tend to fare better when they focus on scope and burden, as Clayton did; in these areas, the legal headwinds are just not as strong. In fact, while FIRREA broadly defines relevance in terms of what the Attorney General ''deems relevant,'' the statute also incorporates by reference the ''limitations'' on civil investigative demands found in the civil RICO statute, which expressly provides for a challenge to a subpoena based on ''any constitutional or other legal right or privilege'' of the person receiving the subpoena.[24] In this context, one such constitutional limitation on administrative subpoenas is the ''reasonableness'' requirement of the Fourth Amendment.[25]

An administrative subpoena exceeds the boundaries of the Fourth Amendment if it is not ''sufficiently limited in scope'' and ''specific in directive so that compliance will not be unreasonably burdensome.''[26] For example, in *United States v. Theodore*, the Internal Revenue Service subpoenaed a tax preparation firm as part of a national investigation into tax return preparers, seeking all tax returns for all of the firm's clients for a three-year period.[27] The Fourth Circuit held that the subpoena was ''too broad and too vague'' to enforce.[28] The court stated that the government is not authorized to ''go on a fishing expedition,'' and that ''where it appears that the purpose of [a] summons is a rambling exploration of a third party's files, it will not be enforced.''[29] In another case, *United States Commodity Futures Trading Commission v. The McGraw-Hill Cos., Inc.*, the CFTC sought to enforce a subpoena issued to a third-party publisher, requesting disclosure of data given by an investigative target to the publisher.[30] The court found parts of the subpoena overly burdensome and modified the subpoena accordingly.[31] And in *Equal Employment Opportunity Commission v. McCormick & Schmick's*, the EEOC subpoenaed employment data concerning ''all of respondent's [67] restaurant locations nationwide and all management and non-management positions'' in the context of an employment discrimination investigation concerning three locations in California.[32] The court observed that ''[a]n administrative subpoena will not be enforced if it is overbroad or if compliance would place undue burdens on respondent,'' and modified the subpoena to require production of a random sample of personnel files from 30 locations, based on options previously discussed by the parties as compromises and presented to the court.[33]

Information Already In the Government's Possession

At first blush it may seem that the last factor — whether the government already has in its possession the information demanded by the subpoena — would rarely arise: Why would the government bother to issue a subpoena for documents it already has? But it may not be as trivial as it seems in the current enforcement climate, in which so many federal agencies are simultaneously pursuing the same financial institutions with similar law enforcement objectives. The Financial Fraud Enforcement Task Force, for example, which was established in 2009 ''to hold accountable those who helped to bring about the last financial crisis,''[34] consists of more than 20 federal agencies and all 94 U.S. Attorney's Offices.[35] With all of these federal agencies aggressively pursuing financial fraud, financial firms are bound to receive multiple subpoenas calling for overlapping information. Clayton, for example, argued

[19] 983 F.2d 631, 641–42 (5th Cir. 1993).

[20] *See, e.g., Inspector Gen. of U.S. Dep't of Agric. v. Glenn*, 122 F.3d 1007, 1009–10 (11th Cir. 1997) (disagreeing with *Burlington Northern*); *United States v. Chevron U.S.A., Inc.*, 186 F.3d 644, 647–48 (5th Cir. 1999) (distinguishing *Burlington Northern* on the facts); *Adair v. Rose Law Firm*, 867 F. Supp. 1111, 1117–18 (D.C.D.C. 1994) (declining to extend *Burlington Northern*).

[21] *Doe*, 253 F.3d at 266 (quoting *Endicott Johnson Corp. v. Perkins*, 317 U.S. 501, 209 (1943)).

[22] *Powell*, 379 U.S. at 58; *Fed. Trade Comm'n v. Invention Submission Corp.*, 965 F.2d 1086 (D.C. Cir 1992); *Texaco*, 555 F.2d at 877 n.32, 882.

[23] *United States v. Clayton Holdings, LLC*, No. 13 Civ. 116 (D. Conn. Oct. 1, 2013) (United States' Reply Memorandum (''Government's Reply'') at 7).

[24] 12 U.S.C. § 1833a(g)(2) (citing 18 U.S.C. §§ 1968(g), (h), (j)).

[25] *See v. City of Seattle*, 387 U.S. 541, 544 (1967).

[26] *Id.*

[27] 479 F.2d 749, 753–55 (4th Cir. 1973).

[28] *Id.* at 753–55.

[29] *Id.* at 754 (internal citation omitted).

[30] 390 F. Supp. 2d 27 (D.C.D.C. 2005).

[31] *Id.* at 35–36.

[32] No. C-07-80065 (N.D. Cal. May 15, 2007).

[33] *Id.* at *7.

[34] *See* About the Task Force, available at http://www.stopfraud.gov/about.html (last visited Nov. 6, 2013). Along with the RMBS Working Group, the Task Force also consists of nine other working groups aimed at investigating financial fraud, including the Consumer Protection Working Group, the Mortgage Fraud Working Group, and the Securities and Commodities Fraud Working Group. *See* Task Force Leadership, available at http://www.stopfraud.gov/leadership.html (last visited Nov. 6, 2013).

[35] *Id.*

that it had cooperated with the RMBS Working Group for more than six years and had already produced millions of documents to multiple DOJ components, including documents that were within the scope of the most recent FIRREA subpoena.[36] It seems unnecessary and unreasonable for targets or third parties to have to comply with multiple government subpoenas for essentially the same information, especially given the costs and burden that each subpoena imposes on the recipient. This factor, therefore, may take on increasing importance in the current enforcement climate.

Round One: To the Government

On Nov. 11, 2013, a federal magistrate judge largely sided with the government against Clayton in this dispute, issuing a decision that recommended that the district court reject Clayton's challenge.[37]

At the outset, the court observed that the government had voluntarily withdrawn five of the eight categories of documents that it had originally requested in the subpoena. The court therefore recommended that the government's motion be denied as to those categories, without prejudice to re-filing.[38] Turning to Clayton's relevance objection, the court recommended a ruling for the government, finding that the government's relevancy determination was not ''obviously wrong.''[39] The court next held that Clayton had not met its burden of establishing that the subpoena was overly broad or unduly burdensome.[40] With respect to emails, the court observed that the government had offered to negotiate search terms with Clayton to narrow the universe of responsive documents, and to enter into a ''claw back'' agreement for the return of documents erroneously produced.[41] The court held that Clayton had not met its heavy burden of showing that compliance with the subpoena threatened to ''unduly disrupt or seriously hinder normal operations'' of Clayton's business.[42]

Significantly, the court sustained the government's right to subpoena documents for those of Clayton's clients that were not targets of any investigation.[43] Analogizing the government's power of inquiry under a FIRREA subpoena to the power of the grand jury to investigate ''merely on suspicion that the law is being violated, or even just because it wants assurance that it is not,'' the court found that Clayton had not met its burden of demonstrating that the subpoena was unreasonable in its scope.[44] Finally, the court rejected Clayton's argument that it should not be compelled to produce documents that it had already produced in other investigations, finding that some level of ''redundancy'' between this subpoena and others should not be enough to defeat the government's right to the documents requested.[45]

In sum, the government largely prevailed in this initial round with Clayton, although Clayton retains the right to object to the magistrate judge's recommended decision before the district court.

A Battle Worth Fighting?

When deciding whether to challenge a FIRREA subpoena, the likelihood of success under the factors cited above weighs heavily in the analysis. But consideration should also be given to defining success for such a challenge, as there may be outcomes short of quashing the subpoena in its entirety that may justify pursuing such a challenge. Partial success may consist, for example, in narrowing the scope of the subpoena, or otherwise reducing the cost of production, in ways that exceed what the government may have offered outside of court. Accordingly, the decision to challenge a subpoena should be informed by the answers to these additional questions as well:

- First, is the subpoena recipient the target of the investigation or merely a third party? A witness to an investigation of others — such as Clayton Holdings — may have less reputational risk (at least for itself) in the public disclosure of the investigation than would come with a court challenge. And, a witness may not have the same concerns as a target would in appearing less than fully cooperative with the agency or the investigators.

- Second, if the subpoena recipient is the target, is the investigation already public? It is often the case that public companies disclose the existence of the subpoena and the investigation in their securities filings. When the investigation is already public, there may be less downside in exposure to press reports that the company (while generally cooperating) is pushing back against a subpoena perceived to be unreasonable and overbroad.

- Third, how reasonable has the government been in its negotiations over the subpoena? Whether to challenge a subpoena generally does not turn on the scope and burden of the subpoena *as written*, but the scope and burden of the subpoena as narrowed and reduced through negotiation with the government. When the government serves the subpoena, it may draft the subpoena broadly but be willing to negotiate. Also, because the government generally does not know detailed information about how the subpoena recipient maintains its files, the subpoena as drafted may impose costs that the government simply does not appreciate until those systems and costs are explained. Unless the government is being unreasonable, effective negotiation with the government can often reduce the scope and burden of the subpoena to an acceptable level and avoid the risks and costs attendant to a court challenge. In fact, courts often will insist that the parties attempt to resolve disputes over the subpoena informally before allowing a party to challenge it in court. Notably, in Clayton's case, the court cited to the government's pre-enforcement offer to negotiate search terms and to enter into a claw-back agreement when it rejected Clayton's arguments regarding burden.

- Fourth, if the subpoena recipient is a major financial institution that has become a repeat player in government investigations, is it important to send a message for this and future investigations that the company will insist upon reasonableness from the government, and will not simply roll over to every demand? If the financial institution has already complied with multiple

[36] Respondent's Br. at 14–15, 20, 23.
[37] *United States v. Clayton Holdings, LLC*, No. 13 Civ. 116 (D. Conn. Nov. 11, 2013) (Recommended Ruling at 1, 8).
[38] *Id*. at 3.
[39] *Id*. at 4, 6.
[40] *Id*. at 5.
[41] *Id*. at 7–8.
[42] *Id*.
[43] *Id*. at 5.
[44] *Id*.
[45] *Id*. at 6–7.

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subpoenas for the same or similar information, it may wish to consider whether there is value in pushing back and seeking to narrow the scope of the subpoena to information already in the government's possession.

■ Finally, how do the costs of compliance with the subpoena compare with the costs of challenging the subpoena? The procedure to challenge a FIRREA subpoena is relatively simple: The challenger files a petition to set aside or modify the subpoena in federal district court within twenty days after service, or any time prior to the return date, whichever date is earlier. Merely filing a petition challenging the subpoena and engaging the court as a neutral third party to resolve the dispute may change the dynamic with the government, from one in which the government holds all the cards to one in which the government (like the challenger) is at the mercy of the judge. By injecting into the negotiations the risk that the government will lose, the challenger may be able to negotiate more favorable limits on the scope of the subpoena than the government might have been willing to agree to in the absence of such a court challenge.

Conclusion

Although Clayton largely lost round one of its battle with the RMBS Task Force, it remains to be seen whether Clayton will ultimately prevail in this rare court challenge to a FIRREA subpoena. In its opinion, the magistrate judge arguably broke new ground by equating the reach of a civil FIRREA subpoena with that of a criminal grand jury subpoena, even though the government may issue FIRREA subpoenas only in ''civil investigations'' in contemplation of ''civil'' proceedings,'' and FIRREA incorporates by reference statutory ''limitations'' on the government's subpoena power that do not apply in criminal investigations.[46] Moreover, at least one court has observed that subpoenas issued by the Justice Department ''do not qualify as administrative subpoenas in the traditional sense'' because the Justice Department is a law enforcement agency gathering evidence and not an administrative agency seeking information from an entity it regulates,[47] thus raising the question of whether the courts' traditional deference to ''administrative subpoenas'' applies with equal force in this context.

But in a way, Clayton has already won, at least in one respect: As the court observed in its opinion, the government withdrew five of the eight categories of documents originally sought by the subpoena after Clayton challenged it,[48] choosing to pick its battles more carefully in court than it did in the subpoena. ''Our courts,'' Atticus Finch famously remarked, ''are the great levelers.'' While the law may give the government the upper hand in challenges to FIRREA subpoenas, those facing an unreasonable subpoena may be surprised to find themselves on a somewhat more level playing field with the government if they are willing to take the government to court.

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[46] 12 U.S.C. § 1833a(g).

[47] *In re Subpoena Duces Tecum*, 51 F. Supp. 2d 726, 730–31 (W.D. Va. 1999) (''While commentators have referred to these [HIPAA] subpoenas as 'administrative subpoenas,' they do not qualify as administrative subpoenas in the traditional sense. Administrative subpoenas typically are issued by an agency which is seeking information from an individual or entity which it regulates to confirm compliance with its regulations. This Act, however, empowers the federal government's prosecutors, the Attorney General and her designees, local U.S. Attorneys, to gather evidence of suspected criminal activity.'').

[48] *See* Government's Reply at 4 n.1; Transcript of Order to Show Cause Hearing at 11:6–12:6, 13:2–10, *United States v. Clayton Holdings, LLC*, No. 13 Civ. 116 (D. Conn. Oct. 3, 2013).