Trial Practice Update

Two recent decisions in *MBIA Insurance Corp. v. Countrywide Home Loans , Inc.*, No. 602825/08 (N.Y. Sup. Ct. Dec. 22, 2010), one of the most closely-followed residential mortgage-backed securities ("RMBS") cases in the country, involved significant trial-related issues. In the suit, MBIA alleges that Countrywide fraudulently induced it to insure $21 billion dollars' worth of RMBS by falsely representing that Countrywide originated the loans in strict compliance with its underwriting standards and guidelines, when in fact it knowingly and routinely approved borrowers who could not afford to repay the loans, committed fraud in loan applications, or otherwise did not satisfy the basic risk criteria for prudent and responsible lending that it claimed to use.

First, Justice Eileen Bransten of the New York Supreme Court, ruled *in limine* that MBIA could use statistical sampling of the loan pools to prove its claims of fraud and breach of contract. In so doing, the court effectively freed the plaintiff from proving its case on a loan-by-loan basis. Doing so would have been impossible because more than 360,000 loans are at issue. The court instead approved a methodology allowing the plaintiff to sample 400 loans from each of 15 securitizations. The ruling granted MBIA a "powerful tool" for establishing its claims, allowing it to bypass the "costly and time consuming process" of proceeding on a loan-by-loan basis. *See*, John Carney, *Bank of America Loses Key Battle in Mortgage Fraud Fight*, CNBC, Dec. 23, 2010, http://www.cnbc.com/id/40794336. In granting MBIA's motion, the court rejected the defendants' contention that the motion was premature because discovery had not yet closed. It held that New York law permits parties to motion *in limine* "as their litigation strategy dictates."

The court also concluded that statistical sampling meets the *Frye* test, the New York standard that imposes a higher threshold than *Daubert* for the admissibility of expert testimony. The court agreed that statistical sampling is not novel and observed that "[i]t is undisputed that the use of statistical sampling is generally accepted in the scientific community." The court found that MBIA's methodology of selecting a sample stratified by relevant criteria, was acceptable. Accordingly, the court held that, although challenges to MBIA's methodology could be mounted at trial, there was no bar to the admissibility of the proof based on sampling, and it would be a jury question whether the proof was probative and sufficient to prove MBIA's case.

In its subsequent January 28, 2011 decision, the court held that a party's pre-litigation analysis can be protected by the work-product doctrine, attorney-client privilege, and New York's trial-preparation privilege. At issue was whether MBIA had properly claimed privilege as to materials produced by non-testifying consultants it retained in anticipation of litigation to re-underwrite the mortgage loans underlying the securitizations. Doing so led MBIA to seek a contractual "put back" remedy before commencing suit, *i.e.*, requesting that Countrywide repurchase approximately 4,689 loans that failed to comply with Countrywide's representations and warranties. MBIA, through outside counsel, retained the consultants in early 2008 to work under its oversight. Once litigation commenced, Countrywide sought to discover the consultants' work product.

Countrywide contended that the majority of documents neither sought nor reflected the advice of counsel and therefore were not protected by the attorney-client privilege. The materials also were not attorney work product, according to Countrywide, because they were not prepared by counsel and were not produced "solely" in anticipation of litigation, but also served its business purpose to determine whether the loans were originated in compliance with Countrywide's underwriting guidelines and were serviced according to its servicing guidelines. Countrywide additionally argued that MBIA's reference to the results of the consultants' investigations in its complaint waived any trial preparation privilege.

The court rejected each of Countrywide's arguments. It noted that notwithstanding New York's policy favoring liberal discovery, "C.P.L.R. § 3101 establishes three categories of protected materials: privileged matter, absolutely immune from discovery (C.P.L.R. § 3101(b)); attorney work product, also absolutely immune (C.P.L.R. § 3101(c)); and trial preparation materials, which are subject to disclosure only on a showing of substantial need and undue hardship in obtaining the substantial equivalent of the materials by other means (CPLR § 3101(d)(2)."

The court held that because outside counsel hired and directed the consultants, and then used the results of their investigations to provide legal advice to MBIA, the consultants' were acting as "agents" of counsel. Thus, communications between the consultants and outside counsel, as well as the consultants' communications with MBIA employees, were privileged. Further, the document the consultants created were protected by the attorney work-product privilege because they were prepared "in furtherance of their respective investigations [and] were used by outside counsel to assist in analyzing and preparing advice upon MBIA's legal remedies."

Importantly, the court rejected Countrywide's argument that the attorney work-product privilege applied only to materials created solely for purposes of litigation. Acknowledging that "[New York c]ase law has, at times, placed an emphasis on the term[s] 'solely' or 'purely' in finding against privilege protection and for disclosure based upon the purpose of the document," the court nonetheless declared that the "proper test for whether documents are to be accorded protection [as work product] is not a didactic test as to whether the documents are created solely for purposes of litigation, but whether the documents were created primarily for the purpose of litigation."

In ruling that the touchstone should be whether the documents were created primarily for the purpose of litigation, the court reasoned that: "finding that the work product of an investigation resulting in multiple avenues of legal recourse, including one other than litigation, is absolved of an otherwise applicable privilege is to force the investigating party into a modified Hobson's choice of either litigating and retaining privilege (and therefore losing possible avenues of recourse) or pursuing all recourse and losing important attorney client and/or work product privileges." The court also found that the due diligence conducted by MBIA prior to the filing of the complaint did not remove the documents from privilege. It noted that, as a policy matter, the privilege encourages parties to diligently examine their claims prior to approaching the court without fear that the documents will be discoverable.

Finally, the court ruled that the trial-preparation privilege also protected materials produced by MBIA's consultants. Countrywide had failed to demonstrate a "substantial need" for the consultants' documents that might overcome the privilege, because Countrywide had all the documents and facts necessary to defend itself. Equally unsuccessful was Countrywide's argument that MBIA had somehow improperly used the consultants' materials as a sword and a shield by referring to results of the consultants' analysis in the complaint, while refusing to disclose the underlying work papers. In doing so, MBIA did not put the non-testifying consultants' material "at issue" because it did not intend to prove its claims with that material.