2007 WL 7126572 (N.Y.Sup.) (Trial Order)
Supreme Court of New York.
New York County

BEAR, STEARNS & CO. INC., Plaintiff,
v.
MCKESSON CORPORATION, Defendant.

No. 604304/2005.
May 16, 2007.

**Decision and Order**

Hon. Karla Moskowitz, Justice.

MOTION SEQ. NO. 004

The following papers, numbered 1 to ___ were read on this motion to/for _____

| | **PAPERS NUMBERED** |
|---|---|
| Notice of Motion/ Order to Show Cause - Affidavits - Exhibits ... | _____ |
| Answering Affidavits - Exhibits _____ | _____ |
| Replying Affidavits _____ | _____ |

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is

ORDERED that this motion is decided in accordance with the accompanying Decision and Order.

Dated: May 16, 2007

<<signature>>

KARLA MOSKOWITZ *J.S.C.*

The court consolidates motion sequence numbers ?? in this decision.

In motion sequence number 004, non-party the New York State Common Retirement Fund ("NYSCRF") moves for a protective order, pursuant to CPLR 3103 (a), of a subpoena that plaintiff Bear, Steams & Co. Inc. ("Bear Steams") served upon NYSCRF.

In motion sequence number 005, Bear Steams moves, pursuant to CPLR 3124 and 3125, to compel: (a) defendant McKesson Corporation ("McKesson") to produce documents responsive to certain of Bear Steams' First Request for Production of Documents and to provide complete responses to certain of Bear Steams' First Set of Interrogatories; and (b) non-parties Skadden Arps Slate Meagher & Flom LLP ("Skadden"), Bingham McCutchen LLP ("Bingham"), NYSCRF, Bernstein Litowitz Berger & Grossman LLP ("Bernstein") and Barrack Rodos & Bacine ("Barrack") to produce certain documents responsive to subpoenas Bear Steams issued to each of them.

As discussed below, California's mediation privilege (California Evidence Code § 1119) protects these documents from discovery.

***BACKGROUND***

This action arises from three securities-related litigations brought against McKesson and Bear Stearns and involves three agreements between Bear Steams, on the one hand, and McKesson (or one of McKesson's predecessors in interest), on the other. The parties have settled in full two of those cases. In the third, referred to as the Securities Action, the plaintiffs have settled in full as against McKesson but are still proceeding against Bear Steams. That action will go to trial later this year.

In 1998, McKesson hired Bear Steams to serve as a financial advisor for McKesson's proposed merger with HBO & Company, Inc. ("HBOC") and to deliver an opinion, known as a "Fairness Opinion," of the terms of the proposed merger ("HBOC Merger"). The parties set forth the terms of Bear Steams' engagement in a letter agreement, dated October 14, 1998, and executed on October 17, 1998 ("Engagement Agreement"). The Engagement Agreement has an annex entitled "Indemnification Provisions," that the Engagement Agreement incorporates by reference and that contains various provisions for indemnification and contribution ("Indemnification Agreement"). The Indemnification Agreement contains the Consent Provision, the Indemnification Provision, the Settlement Reimbursement Provision, the Expense Reimbursement Provision and the Equitable Allocation Provision.

*The Consent Provision* requires McKesson to obtain Bear Steams' written consent prior to settling any lawsuit arising from the merger, or, alternatively, to obtain, as a term of any settlement it enters, an unconditional and irrevocable release of all claims that the claimant may have against Bear Steams.

*The Indemnification Provision* requires McKesson to indemnify and hold Bear Steams harmless for any liabilities arising from Bear Steams' services pursuant to the Engagement Agreement, unless a court finds the liabilities resulted directly from the gross negligence or willful misconduct of Bear Steams.

*The Settlement Reimbursement Provision* requires McKesson to reimburse Bear Steams for any settlement of claims against Bear Steams arising from the HBOC Merger or Bear Steams' services pursuant to the Engagement Agreement, but McKesson must give prior written consent and cannot unreasonably withhold consent.

*The Expense Reimbursement Provision* requires McKesson to reimburse Bear Steams for all costs and expenses Bear Steams incurs in connection with any litigation and investigations arising from the HBOC Merger or Bear Steams' services pursuant to the Engagement Agreement, unless Bear Steams engaged in gross negligence or willful misconduct.

Additionally, the *Equitable Allocation Provision* provides that, in the event a claim for indemnification or reimbursement under the Engagement Agreement is unenforceable, then: (a) McKesson and Bear Steams will equitably allocate any liabilities, costs or expenses that Bear Steams incurs in proportion to their relative benefits and relative fault; and (b) Bear Steams shall not be responsible for paying any amount that exceeds the amount of fees Bear Steams received pursuant to the Engagement Agreement.

After completion of the HBOC Merger, McKesson issued corrected financial statements because it found certain improprieties in HBOC's financial statements. HBOC, McKesson, Bear Steams, Arthur Anderson LLP (HBOC's former accounting firm) then became defendants in a number of securities fraud class actions. Specifically, the plaintiffs in these class actions accused them of fraud, material misstatements to the public and other wrongdoing. The court consolidated the

class actions into the Securities Action and appointed NYSCRF the lead plaintiff.

The Securities Action complaint names Bear Steams with respect to Count VIII for violation of § 14 (a) of the Securities Exchange Act of 1934 (material misstatements or omissions in proxy materials). Plaintiffs predicate the § 14 (a) claim on the Fairness Opinion that they claim Bear Steams issued with objectively and subjectively false and misleading information. The court, however, previously dismissed, as against Bear Steams, Count IV of the Securities Action complaint, that asserted a claim under § 10 (b) of the Securities Exchange Act of 1934 (fraud in connection with the purchase or sale of securities).

In January 2005, McKesson and NYSCRF announced that, following mediation, they had reached a settlement in the Securities Action in which McKesson agreed to pay NYSCRF and the putative class $960 million ("Settlement Agreement"). Edward A. Infante, formerly Chief Magistrate Judge of the United States District Court, Northern District of California, acted as the mediator. The mediation involved two face-to-face sessions between McKesson and NYSCRF (October 9-10, 2003 and July 9-10, 2004) in California, and numerous follow-up communications, in order to negotiate various aspects of the final Settlement Agreement. The resulting Settlement Agreement received final court approval on February 24, 2007. In the Settlement Agreement, the parties settled all claims against all parties, except claims against Bear Steams and Arthur Anderson.

The case management order in the Securities Action provides for a factual discovery cut-off date of August 18, 2006. The court has scheduled the trial to begin in autumn 2007.

In this action, Bear Steams contends, inter alia, that: (a) the Settlement violates the Consent Provision, because McKesson did not seek or obtain Bear Steams' consent to the Settlement and it does not contain an unconditional release of the plaintiffs' claims against Bear Steams; and (b) McKesson violated the Engagement Agreement by agreeing to the Settlement and intentionally deprived Bear Steams of important rights and exposed Bear Steams to the risk of substantial additional liability. Among other things, Bear Steams seeks a declaration that the Indemnification Agreement requires McKesson to pay the amount of any judgment against Bear Steams, the amount of any settlement of the claims in the Securities Action and indemnification for its legal expenses in the Securities Action and any related actions.

By decision filed October 25, 2006, this court granted in part and denied in part McKesson's motion to dismiss by dismissing certain causes of action and sustaining others. Causes of action for breach of contract/declaratory judgment (first, fourth, sixth and ninth causes of action) and one for breach of the implied covenant of good faith and fair dealing (fifth cause of action) survived the motion to dismiss.

On January 19, 2007, Bear Steams, by the same counsel that represents it in the federal action, simultaneously served identical subpoenas on NYSCRF and NYSCRF's counsel, Skadden and Bingham, and on McKesson and McKesson's counsel, Bernstein and Barrack. The subpoenas purport to require production of all documents related to the settlement of the Securities Action and include: attorney work product, communications between counsel and its clients, and documents for or relating to mediation and negotiation of the settlement of the Securities Action. In addition, Bear Steams served lengthy interrogatories upon McKesson that asked it, among other things, to identify any violations of the federal securities laws that McKesson contends Bear Steams committed and to produce any supporting documentation.

On February 15, 2007, NYSCRF objected to the subpoenas, and counsel for the parties conferred. NYSCRF takes the position that the information Bear Steams seeks is privileged and that Bear Steams' request is a thinly veiled attempt to obtain additional discovery for the Securities Action, despite the August 18, 2006 discovery cut-off date. On February 8, 2007, NYSCRF moved to intervene in this action, but the court denied the intervention motion.

During the conferral process, NYSCRF suggested that Bear Steams should create and maintain an ethical wall between its lawyers in the Securities Action and this action, but Bear Steams rejected this suggestion. Thereafter, the parties worked out a briefing schedule for these motions.

***DISCUSSION***

McKesson, NYSCRF and the four law firms oppose Bear Steams' motion for an order compelling discovery. Even though

Bear Steams has narrowed its request to seek production of settlement documents relating to Bear Steams only and has agreed to exclude documents that the attorney-client privilege and the attorney work-product doctrine protect, these parties still contest the remaining request. According to McKesson, NYSCRF and the four law firms, Bear Steams calls for the production of documents that are: (a) not material and necessary in the prosecution or defense of this action pursuant to CPLR 3101; and (b) protected by California's mediation privilege (California Evidence Code § 1119) that precludes discovery of settlement discussions and documents in the mediation context. Even if the California mediation privilege does not protect the documents, McKesson, NYSCRF and the four law firms assert that CPLR 4547 and Rule 5 of the Rules of the Alternate Dispute Resolution Program of the Commercial Division protect disclosure of the settlement-related documents. They further claim that Bear Steams, as a remaining defendant in the Securities Action, only seeks discovery in this action as an impermissible means to obtain discovery that the Judge in the Securities Action has denied. The non-parties additionally contend that, to the extent any non-privileged documents exist, they are available from McKesson, a party to this action.

Bear Steams contends that California law is inapplicable because it issued the subpoenas and document requests pursuant to New York law in this action that is in a New York state court. Bear Steams asserts that, under New York law (i.e., CPLR 4547 and Rule 5 of the Rules of the Alternate Dispute Resolution Program of the Commercial Division), the document requests and subpoenas are not privileged and therefore McKesson, NYSCRF and the four law firms must comply with them. Bear Steams submits that the California mediation privilege is inapplicable because California Evidence Code § 300 provides that the California Evidence Code applies to all proceedings within the jurisdiction of California State courts. Bear Steams further argues that, even if section 1119 of the California Evidence Code were applicable here, its protection would be limited and would not extend to communications between parties or their counsel that they made any time after the mediation has terminated for 10 or more calendar days. (California Evidence Code, §1125).

In order to determine which state's privilege law applies, New York applies its own choice of law rules. As summarized by District Court Judge Kaplan in *Lego v Stratos Lightwave. Inc.*, "[u]nder New York's choice of law principles, the governing law is that of the jurisdiction which, because of its relationship or contact with the occurrence or the parties, has the greatest concern with the specific issue raised in the litigation." (224 FRD 576, 578 [SDNY 2004] [internal footnotes and quotations omitted]. "In cases requiring a choice of privilege law, the interest analysis usually has led New York courts to apply the law of the jurisdiction in which the assertedly privileged communications were made, which in most of the cases was also the jurisdiction in which the party that made the communications resided." (*Id.* at 579 [footnote omitted]). The rationale for this rule "is that the parties who made the communications expected that those communications would remain confidential under the law of that jurisdiction, and the state has an interest in furthering the policies behind the privilege at issue." (Id.; *see also Delta Fin. Corp. v Morrison*, 13 Misc 3d 1229 [A] [Sup Ct, Nassau County 2006] [relying on *Lego v Stratos Lightwave. Inc.*, *supra*, in applying South Carolina privilege law to determine whether electronic mail sent from South Carolina was a privileged communication]; *Doe v Roe*, 190 AD2d 463, 469-470 [4th Dept 1993]).

Upon analysis, California law applies here. The Securities Action is pending in the Northern District of California. The parties pursued mediation under the supervision and guidance of Judge Infante, a retired California federal judge, who resides in California. The in-person mediation sessions occurred in California. McKesson's headquarters are in California. Moreover, the Stipulation of Settlement provides that its terms "shall be governed by and construed in accordance with the laws of the State of California, without regard to that State's rules regarding conflict of laws, to the extent that federal law does not apply." Thus, I conclude that the center of mediation was California, and the parties expected that the applicable California law would cover them.

The court rejects Bear Steams' argument that, because section 300 of the California Evidence Code provides that the Code only applies to proceedings under the jurisdiction of the California State courts, the California mediation privilege in section 1119 is inapplicable here. State evidence or civil procedure laws, that apply only to proceedings in that state, often contain privilege laws. Choice of law analysis does not stop there, especially when, as here, the statutory mediation privilege in the California Evidence Code is a codification of the state's privilege law. One example is New York's attorney-client privilege. Even though CPLR 4503 codifies the attorney-client privilege, choice of law analysis still considers the attorney-client privilege rule of CPLR 4503 to represent the privilege law of New York. (*See e.g.*, *First Interstate Bank of Oregon. N.A. v National Bank & Trust Co. of Norwich. N.A.*, 127 FRD 186, 188 [D Or 1989]).

The purpose of the California mediation privilege is to encourage free and unfettered dialogue between the parties to the mediation, with the expectation that this open communication will enhance the likelihood of achieving a settlement. (*See*

*Rojas v Superior Court of Los Angeles County*, 33 Cal 4th 407, 93 P3d 260, 265 [2004] [holding that photographs the parties prepared for mediation are privileged under California Evidence Code § 1119 and refusing to craft an exception to the privilege that would permit disclosure upon a showing of "good cause"]; *Foxgate Homeowners' Assn., Inc. v Bramalea California. Inc.*, 26 Cal 4th 1, 13-14, 25 P3d 1117, 1126 [2001] [refusing to craft an exception to the mediation privilege that would permit reporting to the court that a party has disobeyed the court order governing the mediation process]). If the confidentiality of the mediation proceeding depended on the forum in which parties bring a subsequent lawsuit, this condition would defeat the purpose of mediation and chill the free flow of mediation communications. (*See e.g. Lego v Stratos Lightwave. Inc.*, 224 FRD at 579, *supra).*

Section 1119 of the California Evidence Code, and the corresponding provisions, explicitly prohibit discovery of what occurred during or for the purposes of a mediation. California Evidence Code § 1119 states:

Except as otherwise provided in this chapter:
(a) *No evidence of anything said or any admission made for the purpose of, in the course of, or pursuant to, a mediation or a mediation consultation is admissible or subject to discovery, and disclosure of the evidence shall not be compelled,* in any arbitration, administrative adjudication, civil action, or other noncriminal proceeding in which, pursuant to law, testimony can be compelled to be given.

(b) No writing, as defined in Section 250, that is prepared for the purpose of, in the course of, or pursuant to, a mediation or a mediation consultation, is admissible or *subject to discovery, and disclosure of the writing shall not be compelled,* in any arbitration, administrative adjudication, civil action, or other noncriminal proceeding in which, pursuant to law, testimony can be compelled to be given.

(c) All communications, negotiations, or settlement discussions by and between participants in the course of a mediation or a mediation consultation shall remain confidential.

(Emphasis added). In addition, section 1126 of the California Evidence Code reinforces the protection California accords mediation. California Evidence Code § 1126 states: "Anything said, any admission made, or any writing that is inadmissible, protected from disclosure, and confidential under this chapter before a mediation ends, shall remain inadmissible, protected from disclosure, and confidential to the same extent after the mediation ends."

California courts have repeatedly, and forcefully, emphasized that section 1119's privilege reflects the importance California's legislature and courts attach to protecting and enhancing the mediation process. "California's Legislature has a strong policy favoring mediation as an alternative to litigation. Because mediation provides a simple, quick, and economical means of resolving disputes, and because it may also help reduce the court system's backlog of cases, it is in the public interest to encourage its use" (*Doe 1 v Superior Court of Los Angeles County*, 132 Cal App 4th 1160, 1165 [2d Dist 2005]).

Because section 1119 bars disclosure of specified communications and writings associated with a mediation, absent an express statutory exception, the court must deny Bear Steams' motion to compel and grant NYSCRF's motion for a protective order, unless Bear Steams can identify an express statutory exception to the section's broad application. (*Rojas v Superior Court of Los Angeles County*, 93 P3d 260, *supra: Foxgate Homeowners' Assn.. Inc. v Bramalea California. Inc.*, 26 Cal 4th 1, *supra).*

Bear Steams argues that the mediation privilege is not applicable because the privilege does not extend to communications between parties or their counsel that they made at any time after the mediation has terminated for 10 or more calendar days. (California Evidence Code, § 1125). However, the facts support the conclusion that the mediation in fact continued until the parties reached the terms of the final Settlement Agreement. Indeed, Judge Infante submitted a statement to the California court in connection with the Settlement stating that negotiations remained under his supervision while the parties continued to actively litigate for several months, thus confirming that the mediation did not "terminate" until the parties signed the Settlement Agreement. Accordingly, this exception is inapplicable, and the disclosure Bear Steams seeks is subject to the California mediation privilege.

The information Bear Steams seeks in the interrogatories is likewise privileged. To the extent it is not, the court nevertheless

strikes the interrogatories on the grounds that, among other reasons, they are too numerous and burdensome, documents or depositions can provide their answers, and they call for a recitation of facts. The court need not parse through the interrogatories to pick out those interrogatories that are proper, and, accordingly, the court strikes them in their entirety.

***CONCLUSION***

It is ORDERED that motion sequence number 004, by non-party the New York State Common Retirement Fund for a protective order of a subpoena served upon the New York State Common Retirement Fund by plaintiff Bear, Steams & Co. Inc., is granted; and it is further

ORDERED that motion sequence number 005, by Bear Steams to compel defendant McKesson Corporation to produce documents and responses responsive to certain of Bear Steams' First Request for Production of Documents to McKesson and to compel non-parties Skadden Arps Slate Meagher & Flom LLP, Bingham McCutchen LLP, the New York State Common Retirement Fund, Bernstein Litowitz Berger & Grossman LLP and Barrack Rodos & Bacine to produce certain documents responsive to subpoenas issued to each of them, is denied in its entirety; and it is further

ORDERED that Bear Steams' First Request for Production of Documents is stricken.

Dated: May 16, 2007

<<signature>>

J.S.C.

**End of Document**