ALERT MEMORANDUM

New York's Highest Court Holds Common Interest Doctrine Inapplicable to Commercial Transactions Absent Litigation

June 14, 2016

In a decision with important consequences for merger and acquisition transactions and the litigation resulting from those transactions, a divided New York Court of Appeals held last week that the common interest doctrine applies only to post-signing, pre-closing communications between parties to a merger agreement if they relate to pending or anticipated litigation. Other communications between separately represented parties to a merger (or other commercial transaction) are not entitled to privilege under New York law.

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Executive Summary

In *Ambac Assurance Corp., et al. v. Countrywide Home Loans, Inc., et al.*, 2016 N.Y. Slip. Op. 04439 (N.Y. June 9, 2016) ("*Ambac II*"), the New York Court of Appeals considered whether New York's common interest doctrine shields from discovery post-signing, pre-closing communications between counsel for a target company and its acquirer, even if neither party contemplated litigation at the time of the communications. Reversing the decision of the Appellate Division, First Department, the Court of Appeals ruled as follows: "Under the common interest doctrine, . . . an attorney-client communication that is disclosed to a third party remains privileged if the third party shares a common legal interest with the client who made the communication and the communication is made in furtherance of that common legal interest. We hold today, as the courts in New York have held for over two decades, that any such communication must also relate to litigation, either pending or anticipated, in order for the exception to apply."[1]

[1] *Ambac II* at 2. All citations refer to an uncorrected opinion that is subject to revision before official publication.

Background

The case arose out of the guarantee by Ambac Assurance Corporation ("Ambac") of certain residential mortgage-backed securities issued by Countrywide Home Loans, Inc. and its affiliates ("Countrywide") between 2004 and 2006. After the securities failed, Ambac sued Countrywide alleging, among other things, that Countrywide had fraudulently induced Ambac to insure the securities. Ambac likewise sought to hold Bank of America Corp. ("BAC") liable as Countrywide's successor-in-interest, based on BAC's having acquired Countrywide in July 2008.

The dispute in *Ambac II* concerned Ambac's efforts to obtain discovery of approximately 300 communications exchanged between Countrywide and BAC from January 11, 2008, when the Countrywide/BAC merger agreement was signed, until July 1, 2008, when the merger was consummated. BAC resisted disclosure, arguing that these communications, many of which related to Countrywide's and BAC's joint efforts to prepare the various disclosures required by federal law for mergers of public companies, were protected by the attorney-client privilege. Since Countrywide and BAC shared a common legal interest in closing the transaction, BAC argued, under the common interest doctrine, that the attorney-client privilege was not waived when the communications were disclosed to the other party to the merger agreement. For its part, Ambac drew upon a line of cases holding that the common interest doctrine applies only where the parties to the communications had a shared legal interest in pending or expected litigation, and that, because there was no expectation of litigation in relation to the BAC/Countrywide merger when the communications were made, BAC could not invoke the doctrine in that case.

The First Department Opinion

In *Ambac Assurance Corp., et al. v. Countrywide Home Loans, Inc., et al.*, 124 A.D.3d 129 (1st Dep't 2014) ("*Ambac I*"), the Appellate Division of the Supreme Court, First Department, held that New York's common interest doctrine shields from discovery post-signing, pre-closing communications between counsel for a target company and its acquirer even if neither party contemplated litigation at the time of the communications. While acknowledging the existence of contrary authority from its sister courts,[2] the First Department grounded its reasoning in the fact that the "'attorney-client privilege is not tied to the contemplation of litigation.'"[3] Therefore, the First Department reasoned, the application of the common interest doctrine, which "descends" from the attorney-client privilege, should not depend upon the pendency or expectation of litigation.[4] The First Department relied upon a variety of authorities in support of its conclusion, including: the federal courts, which it noted have "overwhelmingly rejected" the argument that the common interest doctrine requires pending or anticipated litigation;[5] the Restatement of the Law Governing Lawyers, which takes the same position;[6] and Rule 502(b) of the Uniform Delaware Rules of Evidence, which codifies the common interest doctrine without requiring the pendency or anticipation of litigation.[7] Finally, the First Department described its conclusion as "the better policy," as it would encourage the parties to a merger agreement to seek the advice of counsel together, thereby potentially reducing follow-on litigation as the companies navigate the complicated integration and regulatory issues inherent to consummating the merger.[8]

The *Ambac II* Majority Opinion

Ambac appealed from the First Department decision, presenting the relevant issue as follows: "Under New

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2 *See Ambac I*, 124 A.D.3d at 135 (citing contrary authority from New York's Second Department).

3 *Id*. at 133 (citing *Spectrum Sys. Intl. Corp. v. Chemical Bank*, 78 N.Y.2d 371, 380 (1991)).

4 *Ambac I*, 124 A.D.3d at 133.

5 *Ambac I*, 124 A.D.3d at 134-35 (citing *United States v. Schwimmer*, 892 F.2d 237 (2d Cir. 1989)).

6 *Ambac I*, 124 A.D.3d at 134-35.

7 *Id*. at 137.

8 *Id*. at 135.

York law, may a party invoke the common interest doctrine to shield from disclosure communications that it voluntarily shared with a third party, even if litigation was not pending or reasonably anticipated at the time when the communication was shared?"[9]

In an opinion authored by Judge Pigott, the Court of Appeals noted the "[o]bvious tension" between the attorney-client privilege and "the policy of this State favoring liberal discovery."[10] The Court then recited a history of the common interest doctrine from its establishment in the nineteenth century to enable criminal defense attorneys to coordinate the defenses of their jointly-indicted clients,[11] to its modern-day application in civil matters,[12] noting that, "until the First Department's decision in this case, New York courts uniformly rejected efforts to expand the common interest doctrine to communications that do not concern pending or reasonably anticipated litigation."[13]

The Court then turned directly to the question at hand, and reasoned as follows: "Disclosure is privileged between codefendants, coplaintiffs or persons who reasonably anticipate that they will become colitigants" because otherwise "the threat of mandatory disclosure may chill the parties' exchange of privileged information and therefore thwart any desire to coordinate legal strategy."[14] Moreover, "when [the] parties are most likely to expect discovery requests[,] . . . their legal interests are sufficiently aligned that 'the counsel of each [i]s in effect the counsel of all.'"[15] By contrast, the majority concluded, "[t]he same cannot be said of clients who share a common legal interest in a commercial transaction or other common problem but do not reasonably anticipate litigation." Retaining the requirement of pending or anticipated litigation, the Court reasoned, would limit the common interest doctrine "to situations where the benefit and necessity of shared communications are at their highest, and the potential for misuse is minimal."[16] In particular, the majority expressed concern that "[t]he difficulty of defining 'common legal interests' outside the context of litigation could result in the loss of evidence of a wide range of communications between parties who assert common legal interests but who really have only non-legal or exclusively business interests to protect."[17]

The Court then addressed BAC's arguments against the pending or anticipated litigation requirement. BAC contended that highly regulated entities such as itself "constantly face a threat of litigation," and that broadening the scope of the common interest doctrine would "facilitate better legal representation, ensure compliance with the law and avoid litigation."[18] But the Court concluded that the cloak of the common interest doctrine was not necessary to encourage robust communication between parties to a merger transaction, as "when businesses share a common interest in closing a complex transaction, their shared interest in the transaction's completion is already an adequate incentive for exchanging information necessary to achieve that end."[19] In response to the argument that the common interest doctrine should not be subject to limitations to which the attorney-client privilege itself is not subject, the Court stated that "the common interest doctrine does not need to be co-extensive with the privilege because the doctrine itself

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9 Br. for Pls.-Appellants at 4.

10 *Ambac II* at 7 (citations omitted).

11 *Ambac II* at 10 (citing *Chahoon v. Commonwealth*, 62 Va. 822, 839-40 (1871)).

12 *Ambac II at 11* (citing *Schmitt v. Emery*, 211 Minn. 547 (1942)).

13 *Ambac II* at 13 (citation omitted).

14 *Id*. at 14-15.

15 *Id*. at 15 (citing *Chahoon*, 62 Va at 841-42).

16 *Ambac II* at 14.

17 *Id.* at 17.

18 *Id.* at 15.

19 *Id*. at 16; *see also id*. ("Defendants have not presented any evidence to suggest that a corporate crisis existed in New York when our courts restricted the common interest doctrine to pending or anticipated litigation, and we doubt that one will occur as a result of our decision today.").

is not an evidentiary privilege or an independent basis for the attorney-client privilege."[20]

In sum, the majority concluded that "the policy reasons for keeping a litigation limitation on the common interest doctrine outweigh any purported justification for doing away with it, and therefore [we] maintain the narrow construction that New York courts have traditionally applied."[21] In a footnote, the Court also noted that the Legislature was free to expand the common interest doctrine by statute.[22]

Judge Rivera's Dissent

While "agree[ing] with the majority that we should stamp our imprimatur on a 'common interest doctrine' and its application in civil cases," Judge Rivera dissented from the majority's holding that an expectation of litigation is necessary for the common interest doctrine to apply.

Like the First Department, Judge Rivera based her reasoning in part on the fact that "the attorney-client privilege has no litigation requirement and the reality that clients often seek legal advice specifically to comply with legal and regulatory mandates and avoid litigation liability."[23] Judge Rivera further disagreed with the majority's conclusion that the common interest doctrine should not apply in commercial transactions because "parties to a business deal already have an incentive to share information that will close the transaction," by observing that parties to litigation have the same incentive to cooperate.[24] Judge Rivera likewise concluded that any attempts to misuse the common interest doctrine in the commercial context could "be addressed through our legal system's existing methods for preventing and sanctioning obstruction of proper discovery." [25]

However, unlike the First Department, which held that "so long as the primary or predominant purpose for the communication with counsel is for the parties to obtain legal advice or to further a legal interest common to the parties, . . . the communications will remain privileged,"[26] Judge Rivera appeared to restrict the scope of her dissent to corporate actors in a merger context—that of "private client-attorney communications exchanged during the course of a transformative business enterprise, in which the parties commit to collaboration and exchange of client information to obtain legal advice aimed at compliance with transaction-related statutory and regulatory mandates."[27]

Key Issues and Takeaways

After *Ambac II*, which further deepened an existing split of authority regarding the scope of the common interest doctrine, parties engaging in commercial transactions face increased uncertainty about whether their communications concerning topics of shared legal interest will be protected from discovery. The answer to that question will depend on which state's law applies to the issue and where suit is filed.

Where New York law governs, it is now clear that post-signing, pre-closing communications between separately represented parties to a merger agreement are not entitled to the protections of the common interest doctrine unless they relate to pending or reasonably anticipated litigation. The question of what constitutes "reasonably anticipated litigation" has been left for consideration in future cases, but separately represented parties to merger agreements governed by New York law should be on notice that their communications with each other (even concerning subjects on which they share a common legal interest) could be subject to discovery.

Ambac II has important implications for communications between corporate lawyers in mergers and other commercial contexts. In this regard, we

20 *Id.* at 18.

21 *Ambac II* at 22.

22 *Id*. at 22 n.6.

23 *Ambac II* at 1 (Rivera, J., dissenting).

24 *Id.* at 10 (Rivera, J., dissenting).

25 *Id.* at 11 (Rivera, J., dissenting).

26 *Ambac I*, 124 A.D.3d at 135.

27 *Ambac II* at 2 (Rivera, J., dissenting).

think it would be prudent for practitioners to consider the following:

- *Legal due diligence*. In a sense, all legal due diligence performed in connection with a merger addresses contingencies that ultimately could lead to litigation. But under *Ambac II*, only communications relating to "reasonably anticipated" litigation are subject to the common interest doctrine. Such matters should be identified and related communications should be segregated from general legal due diligence and memorialized in a privilege log.
- *Deal process and disclosure-related communications*. In the public-company context, merger-related litigation is often viewed as an inevitable by-product of the transaction. It thus seems reasonable to classify communications relating to deal process and fiduciary duties as pertaining to reasonably anticipated litigation.
- *Antitrust/Regulatory Planning*. It is customary for parties and their counsel to enter into a common interest or joint defense agreement to cover communications with respect to the risks and potential remedies pertaining to the antitrust implications of a proposed transaction. *Ambac II* should not alter this practice, as antitrust litigation generally takes place in the federal courts which, as noted above, have largely rejected the requirement that covered communications pertain to pending or anticipated litigation.
- *Consortium Bids; Co-Investment Transactions*. In private equity transactions, it is customary for co-sponsors or other co-investors to receive and review legal due diligence and other memoranda of advice prepared by counsel for the lead sponsor as a means of providing the other investors with the information necessary to make their investment decisions. Typically, the other investors will be asked to enter into a non-reliance letter, in which they acknowledge that they may not rely legally upon the shared work product, and that no attorney-client relationship shall exist as between the investors and lead sponsor counsel. In light of *Ambac II*, the privileged nature of the shared work product may well be lost under this framework. Care should thus be taken to prepare separate memoranda relating to pending and anticipated litigation, which continue to enjoy common interest protection, and to advise clients that other information shared with co-investors may be subject to discovery.
- *Joint ventures; subsidiaries; portfolio companies*. A parent company or private equity sponsor may enter into a common interest agreement with its non-wholly owned subsidiary or portfolio company, to extend the protection of the attorney-client privilege to communications between them. It should be assumed that such protection will apply only to matters relating to pending or anticipated litigation, and that other communications may be subject to discovery.
- *Shared counsel*. It is important to note that *Ambac II* does not appear to affect the vitality of the common interest doctrine with respect to communications between parties who share common counsel. Accordingly, consideration should be given to retaining shared counsel where circumstances permit it.

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