

In an acquisition context, an acquirer will frequently need information to assess risk associated with litigation, regulatory or other issues relating to the target company. In many circumstances, access to the target’s attorney-client privileged information would greatly facilitate that process.

Indeed, in some cases, access to privileged information is the only meaningful way in which the buyer can effectively assess certain risks. Even in the absence of pending litigation or regulatory proceedings, sharing a legal analysis of matters such as the target’s tax reporting positions or intellectual property rights can be important. Legal assessments of “anti-trust risks” associated with a combination can also be of great mutual value to the parties in some contexts. Assessments of risk contingencies can also be crucial to an evaluation of the sufficiency of reserves taken on the target’s financial statements.

One common method for addressing the need to share attorney-client privileged content without defeating that privilege is for the acquirer and the target to rely on a “common interest” privilege.

Until recently, advising transaction parties with respect to the availability of the common interest privilege has been complicated by rulings from state courts in New York that applied different standards for claiming the common interest privilege than those applied in Delaware and most federal courts.

Some of this complexity may be alleviated by the recent decision of the First Department of New York’s Appellate Division in *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.* (December 4, 2014). In that case, the court held that parties to a merger may, in some circumstances, assert a common interest privilege over communications shared with transaction counterparties even if there is no litigation pending or anticipated concerning the issue in question. In taking that position, the First Department took an important step toward aligning New York law with the prevailing standard in Delaware and most federal courts.

Although *Ambac* remains subject to appeal and leaves unanswered a number of important questions as to the scope of the common interest privilege under New York law, when taken together with prevailing law in other jurisdictions, the case suggests measures that transacting parties can take to increase the likelihood of successfully invoking the common interest privilege.

Background of the *Ambac* Decision

Ambac arose in the context of claims brought by Ambac Assurance Corporation against Countrywide Home Loans and certain of its affiliates, as well as Bank of America Corporation. Ambac alleged that Countrywide had fraudulently induced Ambac to insure payments on residential mortgage backed securities for several years. Ambac claimed that Bank of America (which acquired Countrywide in 2008) was liable for Countrywide’s conduct as its successor in interest.

To buttress its successor liability claims, Ambac sought to review several hundred documents reflecting communications between Bank of America and Countrywide and their respective legal counsel during the course of their merger negotiations. Bank of America resisted that disclosure, claiming that Countrywide’s sharing of the privileged documents with Bank of America was protected by the common interest privilege because the parties shared common legal interests.

A special discovery master assigned to the case ordered production of the privileged documents sought by Ambac. The reviewing trial court denied Bank of America’s motion to vacate the master’s order, holding that New York law, as it existed at the time, required a reasonable anticipation of litigation for the common interest doctrine to apply. Since there was no litigation pending with respect to the issues covered by the privileged documents at the time of the merger negotiations, the court ruled that Ambac had a right to review the documents in question.

On appeal, the First Department of the New York Appellate Division unanimously reversed the trial court’s decision, holding for the first time in New York that “pending or reasonably anticipated litigation was not a necessary element of the common interest privilege.” Although recognizing that other New York courts had held to the contrary (and that New York’s highest court had not addressed the issue), the *Ambac* court found that the requirement of pending or threatened litigation was inconsistent with the purposes of the privilege and the weight of authority nationwide.

By declining to require the existence of pending or prospective litigation, the *Ambac* court chose to depart from a line of New York decisions reaching back as far as 2006. The court held that the common interest privilege applied to information shared among Countrywide, Bank of America and their counsel in part because: (1) the parties had signed both a merger and a confidentiality agreement governing their pre-closing exchange of information; and (2) they needed to share the advice of counsel contained within the privileged documents “in order to accurately navigate the complex legal and regulatory process involved in completing the transaction.”

Implications of *Ambac*

Ambac is important because it signals that New York may be moving to align with the prevailing treatment of the common interest privilege in both the federal courts and in Delaware. However, it must be noted that *Ambac* was not issued by New York's highest court and remains subject to appeal. In addition, although *Ambac* is controlling in the First Department of the Appellate Division of the New York Courts (which includes Manhattan) it may not be controlling elsewhere in that state, especially in New York's Second Department, which covers 10 counties (including counties in which Brooklyn and Queens are located). Decisions in the Second Department as recently as last year held that the common interest privilege requires "reasonable anticipation of litigation." (*Hyatt v. State of California Franchise Tax Board*, 105 A.D. 3d 186, 205 (Second Department, 2013).

Unresolved Issues

The *Ambac* decision also leaves open a number of unresolved issues. First, the case does not directly address whether the common interest privilege can apply to communications shared with parties other than the transaction counterparty and their counsel. As a result, providing information to investment bankers or other transaction participants remains an unapproved and risky practice. Some courts have held that the presence of investment bankers within the disclosure group destroys the privilege because they are "not necessary for effective consultation [with respect to legal matters] between transaction parties and their attorneys."

Moreover, while the *Ambac* case directly addresses the application of the common interest privilege to the sharing of communications *after* the execution of the transaction agreement, it does not address whether the common interest privilege can apply *prior* to the execution of a merger or other acquisition agreement – for example during the due diligence process. Some courts have declined to apply the common interest privilege to communications prior to the execution of a merger agreement, finding that the parties' interests at that point are not sufficiently aligned. Other courts, however, have been willing to extend the privilege to cover communications shared with prospective buyers, particularly with respect to communications about post-acquisition litigation. New York law remains unresolved on this point.

Finally, *Ambac* does not address who retains control over the pre-merger communications protected by the common interest privilege after the transaction closes. The general rule is that rights to privileged communications pass to the purchaser upon closure of a merger. Delaware courts have held that parties to a merger agreement can agree to limit the purchaser's post-merger rights to certain privileged communications. In light of this lack of uniformity, sellers should carefully outline their rights with respect to privileged information in the light of the standards of the jurisdiction whose law will be governing their transaction.

Practical Guidance for M&A Participants

Based on *Ambac* and other authorities, parties hoping to rely upon a common interest privilege to facilitate the sharing of information in the context of a business combination can take steps to heighten the likelihood of their success:

- **Strict Confidentiality.** The *Ambac* court specifically referenced the existence of the parties' confidentiality agreement in reaching its decision. Other courts have done so as well. Thus, transaction parties will strengthen their ability to invoke the common interest privilege by executing a written confidentiality agreement. They should also limit the individuals receiving the privileged communications to those strictly necessary. The confidentiality agreement should place limits on distribution and prohibit copying or forwarding of privileged communications. The parties should also refrain from distributing information to parties such as investment bankers not deemed crucial by courts to providing legal advice. When financing sources or their counsel require access to privileged information, novel approaches may be needed to accommodate their needs.
- **Phrasing of Disclosure.** Depending upon the case law in the governing jurisdiction, parties may wish to consider phrasing the disclosure of information that will be protected under the common interest privilege. Providing that information *following* the execution of the merger agreement may be advisable. In those circumstances, it may be necessary to execute a merger agreement containing a termination provision in favor of the acquirer who is then given a reasonable opportunity to review privileged information and a short window in which to exercise its termination right. Use of this procedure may, however, be particularly tricky (or even impractical) when public company disclosure requirements or third party financing are involved.
- **Focus on Legal Interests.** The courts addressing the common interest privilege claim frequently are called upon to assess whether the interest the parties are seeking to promote is either "legal" or "business" in nature. Courts generally hold that furthering common business interests is not a sufficient basis upon which to predicate a claim of common interest privilege. Even the *Ambac* court noted that the doctrine would not apply to advice from a lawyer of a predominantly business nature.

In *Ambac*, the court found that the parties had a common legal interest in navigating the complex legal and regulatory process involved in completing the transaction. Not all transactions will involve such "complex navigation." The transaction parties will strengthen their effort to obtain the benefit of the common interest privilege by thoughtfully enunciating the nature of the legal interests they are seeking to advance and documenting those justifications in their confidentiality arrangements.

Narrowing the scope of persons who are entitled to review the disclosed information to members of the parties' law departments and outside counsel can further buttress a claim that the interests that are being advanced are legal in nature.

- **Involve Litigation or Ethics Counsel.** Transaction counsel who are unfamiliar with the common interest doctrine would be well advised to involve either their litigation colleagues or members of their firm's ethics groups to advise on the intricacies of the privilege and advisable ways of documenting the arrangements.

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