Client Alert

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New York Appellate Division Eliminates "Pending or Reasonably Anticipated Litigation" Requirement for Common-Interest Privilege

By Grant J. Esposito and Jacob J. Perkowski

On December 4, 2014, the New York Appellate Division, First Department, removed previous restrictions on New York's common-interest doctrine when applied to the exchange of privileged information in mergers and acquisitions. Bringing New York in line with Delaware and other jurisdictions, the Appellate Division held that the common-interest doctrine applies to legal interests beyond actual or threatened litigation: "We hold that, in today's business environment, pending or reasonably anticipated litigation is not a necessary element of the common-interest privilege. . . . Indeed, the circumstances presented in this case illustrate precisely the reason that the common-interest privilege should apply — namely, that business entities often have important legal interests to protect even without the looming specter of litigation."[1]

ATTORNEY-CLIENT PRIVILEGE & ITS ROLE IN M&A DEALS IN NEW YORK

As is commonly understood, the attorney-client privilege is designed to "encourage full and frank communication between attorneys and their clients."[2] It ensures that clients can share information with their attorneys in confidence when seeking legal advice—and that their confidential information will not be disclosed. But the attorney-client privilege is not absolute, and generally is waived when otherwise protected information is shared with a third party outside of the attorney-client relationship. This general rule is particularly problematic in the context of mergers and acquisitions, because acquiring companies often ask target companies to disclose privileged information, including assessments of the target's exposure to liability.

The solution is often to exchange otherwise privileged information under the common-interest doctrine, which provides that "a third party may be present at the communication between an attorney and a client without destroying the privilege if the communication is for the purpose of furthering a nearly identical legal interest shared by the client and the third party."[3]

While parties to a transaction routinely enter into common-interest arrangements to share privileged information, the question remained whether the privilege would be respected if a third party challenged the invocation of the common-interest privilege. Many jurisdictions have upheld the common-interest privilege in the merger context, finding that companies seeking to execute a lawful merger or acquisition satisfied the requirement of sharing a common legal interest. But New York took a restrictive view of the doctrine.

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[1] *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, 2014 N.Y. Slip. Op. 08510, at *2 (N.Y. App. Div. Dec. 4, 2014).

[2] *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[3] *Ambac*, 2014 N.Y. Slip. Op. 08510, at *1.

New York state courts historically applied the common-interest privilege only to communications concerning legal advice in *pending or reasonably anticipated litigation* in which the parties had a common interest. This interpretation would not protect the exchange of other privileged information between buyer and seller. And the trial court so held in *Ambac Assurance Corp. v. Countrywide Securities Corp.*, 980 N.Y.S.2d 274, 274 (N.Y. Sup. Ct. 2013).

In *Ambac*, two merging companies shared privileged information in the diligence phase "to advance their common interests in resolving many legal issues necessary for successful completion of the merger."[4] Ambac later alleged that it was fraudulently induced to enter into agreements to insure mortgage backed securities and that it could recoup its losses from the surviving company.

Ambac sought pre-merger communications, arguing that privilege was waived when documents were shared before the merger's completion. Ambac also argued that the pre-merger communications were not privileged because no litigation was pending during the negotiations. The trial court agreed, holding that "New York law does not allow a privilege claim under the common interest doctrine unless there is pending or reasonably anticipated litigation."[5]

NEW YORK'S NEW APPROACH TO THE COMMON-INTEREST PRIVILEGE

On appeal, the Appellate Division reversed. It stated that parties to a merger share common, important legal interests that are distinct from those interests related to pending or threatened litigation.[6]

The Appellate Division looked to Delaware's understanding of the common-interest privilege in its decision. There is no "pending or reasonable anticipation of litigation" requirement for the common-interest privilege in Delaware. Instead, Delaware simply extends the privilege to certain communications "by clients, their representatives, or their lawyers to a lawyer representing another in a matter of common interest."[7]

Aligning itself with Delaware (as well as the federal courts in New York), the Appellate Division held that the common-interest privilege will apply in situations where different parties have a common interest that is "so parallel and non-adverse that, at least with respect to the transaction involved, they may be regarded as acting as joint venturers."[8] Specifically, communications will remained privileged "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, and not to obtain advice of a predominately business nature."[9] The Appellate Division reasoned that the "attorney-client privilege is not tied to the contemplation of litigation," because "advice is often sought, and rendered, precisely to avoid litigation, or facilitate compliance with the law, or simply to guide a client's course of conduct."[10]

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[4] *Ambac*, 2014 N.Y. Slip. Op. 08510, at *2.

[5] *Ambac*, 980 N.Y.S.2d, at 274.

[6] *Ambac*, 2014 N.Y. Slip. Op. 08510, at *2.

[7] *Id.* at *6 (quoting Del. Uniform R. Ev. 502(b)).

[8] *Id.* (quoting 3Com Corp. v. Diamond II Holdings, Inc., 2010 WL 2280734, at *7 (Del. Ch. 2010)).

[9] *Id.* at *4.

[10] *Id.* at *3 (quoting *Spectrum Sys. Int'l Corp. v. Chemical Bank*, 78 N.Y.2d 371, 380 (N.Y. 1991)).

Ambac provides both clarity and comfort to those whose transactions are governed by New York law that they can reap the benefits and cost savings of having deal counsel freely communicate in furtherance of their shared legal interests, "even without the looming specter of litigation."[11]

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[11] *Id.* at *2.