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New York's Highest Court Refuses to Extend Common Interest Doctrine to Privileged Communications Shared in M&A Context

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Client Advisory
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On June 9, 2016, a divided New York Court of Appeals, in *Ambac Assurance Corporation v. Countrywide Home Loans, Inc.*,[1] refused to expand the common interest exception to the attorney-client privilege waiver rule to situations in which there is no pending or anticipated litigation (such as pre-merger communications between merging companies). When privileged attorney-client communications are shared with third parties, the privilege is normally waived, but the communications will remain privileged under the common interest exception if the parties share a common legal interest. The Court's recent decision in *Ambac* overturned a 2014 decision of the Appellate Division, First Department, which held that privileged communications shared between Bank of America Corporation and Countrywide Financial Corporation (after signing a merger agreement but before the merger) were entitled to protection because the parties had a common legal interest in the commercial transaction and the related legal and regulatory process.[2] The recent decision by New York's highest court is consistent with the New York courts' historically narrow view of the common interest doctrine, in contrast to the federal courts which have broadly applied the doctrine even in the absence of ongoing or anticipated litigation. This decision—of significant interest to M&A advisers and lawyers, companies involved in M&A transactions, and commercial litigators—serves as a reminder that communications regarding legal issues between parties to a commercial transaction with common interests will not be protected under New York law unless litigation is pending or anticipated.

The Common Interest Doctrine

The attorney-client privilege protects from disclosure confidential communications between an attorney and a client made for the purpose of seeking, obtaining, or providing legal assistance to the client. The well-recognized rationale for the privilege is to facilitate and promote open dialogue between clients and attorneys and ensure that clients may confide in their attorneys, which is deemed critical to the effective rendering of legal advice to (and representation of) clients.[3] When clients communicate with their lawyers in the presence of third parties or share otherwise privileged communications with third parties, such communications are no longer considered confidential and clients are deemed to have waived the privilege.

One of the primary exceptions to this waiver rule—known as the "common interest exception" or "common interest doctrine"—preserves the privilege for communications shared with or made in the presence of third parties with whom the client shares a *common legal interest* for purposes of furthering the common legal interest.[4] This doctrine has been invoked by criminal co-defendants asserting the same defense, as well as co-plaintiffs and co-defendants in civil actions in which there is a common legal interest. Traditionally, in New York, this doctrine has only

been applied to communications made in the context of pending or reasonably anticipated litigation, while the federal courts will apply the doctrine to shield communications in furtherance of any common legal interest (such as in the context of a purely commercial transaction).[5]

Ambac v. Countrywide

Ambac v. Countrywide is one of the many cases that flowed from the widespread failure of mortgage-backed securities as part of the recent financial crisis. Plaintiff Ambac, an insurer which guaranteed certain residential mortgage-backed securities, brought suit against Countrywide Financial Corporation and affiliates ("Countrywide"), alleging that Countrywide fraudulently misrepresented the quality of the loans which Ambac was guaranteeing. Ambac later named Bank of America Corporation as a defendant, claiming that Bank of America became Countrywide's successor-in-interest and was responsible for Countrywide's liabilities as a result of a 2008 merger in which Countrywide became a wholly-owned subsidiary of Bank of America. The parties were separately represented by counsel in the merger but the merger agreement required them to share (and maintain the confidentiality of) privileged information on pre-closing legal issues.

During discovery, Bank of America refused to produce several pre-closing, merger-related communications between Bank of America and Countrywide and their counsel on the grounds that the documents were protected by the common interest doctrine because they related to legal issues that the companies needed to resolve jointly in connection with the merger (such as regulatory filings and disclosures, tax consequences, contractual obligations, etc.). Ambac moved to compel production of the documents, asserting, *inter alia*, that the privilege had been waived and that the common interest doctrine was inapplicable because the common legal interest did not relate to ongoing or anticipated litigation. The court-appointed referee and the trial court agreed with Ambac, holding that the common interest doctrine would apply only if there was pending or anticipated litigation, and Bank of America appealed. The Appellate Division, First Department reversed, holding that "litigation need not be actual or imminent for communications to be within the common interest doctrine."[6] Ambac subsequently appealed to New York's highest court.

In its decision last week, the Court of Appeals reversed, holding that the common interest doctrine applied only if there was pending or anticipated litigation. Bank of America argued that the common interest exception should not have a "litigation requirement" because the attorney-client privilege has no such limitation. The Court disagreed, stating that the common interest doctrine—an exception to the waiver rule—need not be co-extensive with the attorney-client privilege. Bank of America also urged the Court to follow the approach taken by the federal courts, but the Court looked to prior New York cases and refused to do away with the "litigation requirement that has historically existed in New York."[7]

Bank of America argued that "highly regulated financial institutions constantly face a threat of litigation and that the protection of their shared communications is necessary to facilitate better legal representation, ensure compliance with the law and avoid litigation." In denying this argument, the Court considered the fundamental justification for the common interest exception—the concern and risk that mandatory disclosure would inhibit the exchange of privileged information between litigants with common interests which in turn will prevent cooperative legal strategy. The Court then concluded that the same concern does not exist in the context of clients who share a common legal interest in a commercial transaction because "their shared interest in the transaction's completion is already an adequate incentive for exchanging information necessary to achieve that end." The Court noted the lack of evidence that commercial transactions have not occurred, or that parties to transactions will not comply with the law, because of New York's narrow application of the common interest doctrine. Further, the Court discussed the difficulty of defining "common legal interests" beyond litigation, and how attempting to do so could open the door for abuse of the doctrine. The Court also distinguished between situations in which parties are separately represented (as in this case) and situations in which one attorney represents multiple parties, indicating that co-clients represented by the same attorney can invoke the common interest doctrine to shield communications even in a non-litigation context because "the clients indisputably share a complete alignment of interests in order for the attorney, ethically, to represent both parties."

Justice Rivera (joined by Justice Garcia) dissented. The dissent emphasized that in heavily regulated transactional matters, encouraging the exchange of confidential communications between cooperating parties may further compliance with statutory and regulatory mandates. As to the majority's concern that an unrestricted common interest doctrine will lead to abuse, the dissent pointed out that these fears are entirely speculative, that the courts are equipped to distinguish between commercial and legal interests, and that many federal and state courts have applied a broader common interest doctrine "without disastrous results."

Conclusion

The Court of Appeals has now restored the New York rule limiting the common interest doctrine to cases involving actual or anticipated litigation. The issue of whether such communications will ultimately be protected as privileged may hinge on whether the case is in federal or state court and whether state or federal law claims are being asserted. For example, in New York's federal courts, New York state privilege law applies to state law claims, while federal privilege law applies to claims under federal statutes.[8]

The *Ambac* decision serves as a reminder to M&A advisers and lawyers, and to parties to commercial transactions in New York, that they should exercise discretion in communicating with counterparties and avoid sharing privileged information that they may not want disclosed in connection with post-transaction litigation. Parties and their lawyers may consider having a document sharing protocol that minimizes the risk of disclosure of privileged materials, such as in connection with the loading of due diligence materials into an electronic data room. While it is advisable for separately represented parties to include language in any non-disclosure agreement or merger agreement stating that the parties have a common legal interest in certain shared information, such an agreement alone will not likely prevent discovery of such information as privileged, as courts have held that common-interest agreements cannot create privileges that otherwise do not exist.[9] It is conceivable that circumstances may exist in the pre-closing stage of a merger where parties can reasonably anticipate litigation (in connection with antitrust issues, for example), and the related necessary sharing of legal advice and privileged communications by the parties should be deemed covered under the common interest doctrine. However, parties in New York should not assume that shared communications will be protected by the common interest doctrine and should use caution and good judgment when sharing privileged communications.

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Endnotes

[1] No. 80, 2016 WL 3188989, 2016 N.Y. Slip Op. 04439 (June 9, 2016).

[2] 124 A.D.3d 129, 136-37 (1st Dep't 2014).

[3] *See Spectrum Sys. Int'l Corp. v. Chem. Bank*, 78 N.Y.2d 371, 377 (1991); *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[4] *Ambac*, Slip Op. 04439, at *4-5.

[5] *Id.* at *6 (collecting cases); *United States v. Schwimmer*, 892 F.2d 237, 243-44 (2d Cir. 1989).

[6] *Ambac*, 124 A.D.3d at 135 (quoting *Dura Global Techs., Inc. v. Magna Donnelly Corp.*, No. 07-CV-10945-DT, 2008 WL 2217682, *3 (E.D. Mich. May 27, 2008)).

[7] *Ambac*, Slip Op. 04439, at *5 (citing *Hyatt v. State of Cal. Franchise Tax Bd.*, 105 A.D.3d 186 (2d Dep't 2013) and other cases).

[8] Fed. R. Evid. 501.

[9] *See Aetna Cas. & Sur. Co. v. Certain Underwriters at Lloyd's London*, 176 Misc.2d 605, 613-14 (Sup. Ct. N.Y. County 1998); *Schaeffler v. United States*, 22 F. Supp. 3d 319, 334 (S.D.N.Y. 2014).

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