Upon the signing of a merger agreement, the parties and their advisors—adversaries during the negotiation process—immediately become allies that must work closely together to complete the transaction. To that end, they will coordinate their efforts on a broad range of contractual requirements, including regulatory approvals, third-party consents and filings with the SEC, typically under significant time constraints. In doing so, it is often prudent and efficient for the parties and their advisors to share attorney-client privileged communications in order to achieve legal and regulatory compliance (e.g., to ensure that disclosures related to the contractual requirements are complete and accurate).

In most state and federal jurisdictions, parties to a transaction can share such communications without risk of discovery in later litigation in reliance on the “common interest doctrine” (also known as the “common interest exception”). In New York, however, the state’s highest court recently ruled, in Ambac Assurance Corporation v. Countrywide Home Loans,¹ that the attorney-client privilege afforded by the common interest doctrine extends only to those communications relating to pending or anticipated litigation, and not those relating to transactional matters.

As discussed below, this decision does not reflect the commercial reality of transactional practices.

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¹ Ambac Assurance Corporation v. Countrywide Home Loans, 130 N.Y. 2d 37 (N.Y. 2013)
in a highly regulated environment, and accordingly the New York state legislature should adopt a statutorily crafted common interest exception that would remove the litigation requirement articulated in Ambac.

The Common Interest Doctrine

The attorney-client privilege may be invoked where there exists a communication made between clients and their attorneys (or their respective agents), in confidence, for the purpose of obtaining or providing legal assistance for the client. The purpose of the privilege is to protect the sacred tenet of the attorney-client relationship—i.e., confidentiality. The shield of this privilege is held by the client and is the cornerstone of open dialogue between an attorney and his or her client. Generally, communications between a client and an attorney that are shared with a third party are not protected by the attorney-client privilege. The presence of a third party to the communication generally acts as a waiver to the privilege.

However, under the common interest doctrine, attorney-client communications that are disclosed to a third party that is separately represented by counsel will remain 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.

The Ambac Decision

In January 2008, Bank of America and Countrywide Financial announced that they entered into a plan of merger whereby Countrywide, which was then facing serious financial challenges, would merge into a wholly owned subsidiary of Bank of America. In preparation for the closing of the merger, which occurred in July 2008, Bank of America and Countrywide exchanged certain privileged communications relating to their shared pre-closing undertakings, including their obligations to make the appropriate public filings with the SEC and to secure approvals from various financial services regulators.

Later, a lawsuit was brought against Bank of America and Countrywide by a financial guarantor. In Ambac Assurance v. Countrywide Home Loans, plaintiff Ambac Assurance Corporation, which guaranteed payments on certain residential mortgage-backed securities issued by Countrywide, claimed that Countrywide fraudulently misrepresented the quality of underlying mortgage loans and that, as a result of the merger, Bank of America became Countrywide’s successor-in-interest and was responsible for Countrywide’s liabilities to Ambac.

During discovery, Bank of America withheld certain pre-closing communications between its counsel and counsel for Countrywide on the basis that these communications were protected by the common interest exception to the attorney-client privilege because they pertained to common legal issues that the parties shared in connection with completing the merger. Ambac, however, argued that the voluntary sharing of such confidential communications before the closing of the merger waived any attorney-client privilege because Bank of America’s and Countrywide’s common legal interest did not relate to pending or anticipated litigation, as required by prior New York case law. The

Appellate Division, First Department, agreed with Bank of America and held that the common interest exception applied to the pre-closing communications, regardless of the presence of pending or anticipated litigation.

On appeal, the New York Court of Appeals reversed the decision of the Appellate Division, First Department, stating that the litigation requirement has been the rule in New York for over two decades. In rejecting an expansion of the common interest exception to commercial transactions, the court noted that the interests of counterparties to a commercial transaction are not necessarily aligned to the same extent as those of co-defendants in a litigation and that “any benefits that may attend such an expansion of the doctrine are outweighed by the substantial loss of relevant evidence, as well as the potential for abuse.”

The dissent, however, reasoned that the common interest exception to the privilege should have applied because the attorney-client privilege itself is not tied to the presence of actual or threatened litigation and because clients often seek legal advice specifically in order to avoid litigation. More specifically, the dissent argued that, during the course of a corporate transaction, separately represented parties should be able to exchange privileged and confidential information in order to better comply with their legal and regulatory requirements, thereby jointly producing more complete and accurate disclosure for their investors and regulators in relation to the transaction. The dissent further noted that the “better rule is grounded not in the rote application of a litigation requirement, but
in the legal dynamics of a modern corporate transactional practice.”

Approaches in Other Jurisdictions

Although the manner and extent to which the common interest doctrine is recognized varies broadly from jurisdiction to jurisdiction, most federal courts (as well as the Restatement (Third) of the Law Governing Lawyers) have been consistent in their rejection of a litigation requirement to invoke the doctrine. As noted by the majority in Ambac, courts in the Second, Third, Seventh, Ninth and Federal Circuits do not have a litigation requirement. In addition, Delaware (by statute) is aligned with the federal approach—that is, the attorney-client privilege is recognized as to those communications by clients, representatives or their lawyers to a lawyer “representing another in a matter of common interest.”

Implications and Recommendations

Imagine that two Delaware corporations enter into a merger agreement governed by Delaware law. Relying on the common interest doctrine, as adopted under Delaware law, the parties exchange confidential, privileged communications prior to closing in order to comply in an effective manner with their regulatory requirements. After Ambac, a third party can seek to bring those parties into New York state court and compel disclosure of pre-closing communications between counsel for the parties to the merger. The discovery risk thereby created could only be avoided either by the parties not sharing confidential information prior to closing and thereby potentially providing incomplete or inaccurate public disclosure, or by bearing the incremental expense of jointly retaining a special counsel through which such information could be channeled and thereby shielded for privilege purposes.

Ambac creates meaningful inefficiencies and uncertainties for commercial parties and presents a strong case for a legislative solution in New York. To be sure, there is a delicate balance to be struck. On the one hand, there is a pragmatic need for the parties to a merger transaction to share confidential communications between their respective counsel. On the other hand, there are legitimate concerns about the possible loss of evidence in bona fide third-party litigation. One way to achieve this balance is for the New York legislature to expand the common interest doctrine to also cover those communications made in furtherance of or related to satisfaction and compliance with statutory or regulatory requirements (rather than all privileged communications between or among commercial counterparties).

Under this approach, parties with a common interest in complying with regulatory and statutory mandates in connection with pending transactions (and avoiding fines, litigation and enforcement action through effective regulatory compliance) can exchange information in furtherance of that common objective freely, without waiver of privilege. This approach advances and is consistent with the origins of the common interest doctrine—the ability of attorneys representing co-defendants to share confidential information about defense strategies without waiving the privilege as against third parties.

Advocating for a similar standard in her Court of Appeals dissent, Judge Jenny Rivera noted:

[W]here parties to a merger agreement have a common legal interest in the successful completion of the merger, the privilege should apply to communications exchanged to comply with legal and regulatory requirements related to consummation of the merger … [such a] narrowly crafted exception to third-party waivers … is justified because signatories to a pre-merger agreement are bound with a common interest in completion of the merger.

The majority in the Ambac decision asserts “[t]here is no evidence … that mergers, licensing agreements and other complex commercial transactions have not occurred in New York because of our state’s litigation limitation on the common interest doctrine; nor is there evidence that corporate clients will cease complying with the law.”

The context in which the privilege issue arose in Ambac did not permit such an evidentiary showing to be made. Regardless, the New York legislature need not accumulate such evidence before taking action, but should instead take a common-sense view towards the current business environment. Due to the rapidly evolving regulatory landscape, corporations and financial institutions executing transactions in the midst of complex compliance regimes will invariably encounter challenges and, as a result, would benefit from the protection that prudent information-sharing without risk of discovery would afford. As the preeminent business center in the world, it is in New York’s interest to have laws in place that make New York a desirable venue for sound business practices.
Consistent with what the court in *Upjohn v. United States*\(^{13}\) recognized and appreciated, “the vast and complicated array of regulatory legislation confronting the modern corporation, corporations, unlike most individuals, constantly go to lawyers to find out how to obey the law, particularly since compliance with the law in this area is hardly an instinctive matter.” Further, as the Appellate Division, First Department in *Ambac* understood, “imposing a litigation requirement … discourages parties with a shared legal interest, such as [a] signed merger agreement … from seeking and sharing [] advice, and would inevitably result instead in the onset of regulatory or private litigation because of the parties’ lack of sound guidance from counsel. This outcome would make poor legal as well as poor business policy.”\(^{14}\)

Commercial parties should have certainty that, even when operating in high-risk corporate transactional situations, the candid flow of information in furtherance of a common legal interest shared in a commercial transaction will be shielded from disclosure, particularly where both parties are seeking to comply with important regulations. Among other things, such an approach would mitigate potential impediments to engaging in higher-risk transactions that may be for the greater good of the U.S. economy, such as the acquisition of a failing financial institution. As the majority noted in *Ambac*, the court’s decision may not preclude transactions from taking place in (or with a nexus to) New York, but unless the common interest doctrine is expanded to include confidential discussions in furtherance of the parties’ common regulatory objectives in such transactions, *Ambac* may have a chilling effect on the quality and quantity of the disclosure made by those parties to their investors and regulators. Fundamentally, as stated in the *Ambac* dissent, “business entities often have important legal interests to protect even without the looming specter of litigation.”\(^{15}\)

**Conclusion**

As stated by former New York Chief Judge Judith Kaye in *Madden v. Creative Services*,\(^{16}\) “it is the strength of the common law to respond, albeit cautiously and intelligently, to the demands of common sense justice in an evolving society.”\(^{17}\) The First Department in *Ambac* sought to have the common law adapt to the modern business world in holding that “in today’s business environment, pending or reasonably anticipated litigation is not a necessary element of the common-interest privilege.”\(^{18}\) The majority decision in the Court of Appeals, however, continued to apply the common interest doctrine as it has been construed for over 20 years, leaving it to the legislature to address.\(^{19}\)

As discussed above, the New York legislature should take heed of the changing business environment and rapidly expanding regulatory landscape and promptly act to expand the common interest doctrine to protect from disclosure those communications between counsel for parties with a common interest that are made in furtherance of or related to satisfaction and compliance with statutory or regulatory requirements.\(^{20}\)