SULLIVAN & CROMWELL LLP

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Ambac Assurance Corp. v. *Countrywide Home Loans, Inc.*: New York Appellate Court Applies Common-Interest Privilege to Merger Parties' Pre-Closing Communications

First Judicial Department Breaks With Other New York Courts and Applies Common-Interest Privilege to Communications not Related to Litigation

SUMMARY

On December 4, 2014, the Appellate Division of the Supreme Court of New York, First Judicial Department ("First Department"), issued *Ambac Assurance Corp.* v. *Countrywide Home Loans, Inc.*,[1] a decision holding that parties to mergers or other transactions may, in some circumstances, assert privilege over communications shared among the merger counterparties, even if no litigation is pending or anticipated concerning the issue. In doing so, the First Department joined Delaware and federal courts and departed from prior decisions by some other New York courts that had limited the common-interest privilege for transactions to communications involving pending or anticipated litigation. The First Department based its ruling on the needs of parties to transactions to share common legal advice "in order to accurately navigate the complex legal and regulatory process involved in completing the transaction."

Ambac will assist transactional parties in confidentially sharing privileged communications in furtherance of a common legal interest. However, even among New York appellate courts there are divergent rulings as to whether invocation of the common-interest privilege requires litigation. In addition, although *Ambac* leaves unanswered a number of questions as to the scope of the common-interest privilege under New

York law, there are several steps that transacting parties can take that might increase the likelihood that their shared privileged communications will remain protected. Because privilege determinations are often highly context-specific, we encourage transacting parties to consult with their counsel as to the applicability of the common-interest or other privilege to their circumstances.

BACKGROUND

The First Department's decision arises from a lawsuit in the Commercial Division of the Supreme Court of New York, New York County, by Ambac Assurance Corporation ("Ambac"), a financial-guaranty insurer, against Countrywide Home Loans, Inc. and certain affiliates (collectively, "Countrywide") and Bank of America Corp. ("Bank of America"). In that suit, Ambac alleged that Countrywide fraudulently induced it to insure payments on residential mortgage-backed securities from 2004 through 2006. Ambac claimed that Bank of America (which merged with Countrywide in 2008) was liable for Countrywide's conduct as its successor-in-interest.

In connection with its successor liability claims, Ambac sought disclosure of several hundred documents reflecting communications between Bank of America and Countrywide and their counsel in the period from their entry into a merger agreement in January 2008 until the close of the merger in July 2008. Bank of America resisted disclosure, arguing that the documents were protected by the common-interest privilege and were shared by the parties "to ensure their accurate compliance with the law and to advance their common legal interests in resolving the many legal issues necessary for successful completion of the merger."[2] A special master subsequently ordered production of the documents and the Commercial Division Justice denied Bank of America's motion to vacate the order, reasoning that there must be "a reasonable anticipation of litigation for the common-interest doctrine to apply" and none was present here.[3] Bank of America appealed.

THE FIRST DEPARTMENT'S DECISION

The First Department unanimously reversed, holding for the first time that "pending or reasonably anticipated litigation is not a necessary element of the common-interest privilege."[4] Although recognizing that other New York courts had applied a pending or prospective litigation requirement (but New York's highest court, the Court of Appeals, had not addressed the issue), the First Department found the requirement inconsistent with the purposes of the privilege and with the weight of authority.

The Court observed that the purpose of the attorney-client privilege is "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice," a purpose that applies equally in both litigation and non-litigation contexts.[5] "[A]dvice 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."[6] The Court noted that the

common-interest privilege derives from the attorney-client privilege and its purposes are essentially the same: to "encourage[] parties with a shared legal interest to seek legal assistance in order to meet legal requirements and to plan their conduct accordingly."[7] The Court thus concluded that it made no sense to impose a litigation requirement for the common-interest privilege when none exists for the attorney-client privilege.

In declining to impose a pending or prospective litigation requirement, the Court chose to follow the prevailing approach taken by federal courts and to depart from a line of New York decisions holding to the contrary.[8] The Court held that the New York courts that previously had addressed the issue had erroneously adopted a litigation requirement by relying on cases applying the common-interest privilege in a criminal context, where it applies to communications between co-defendants and their counsel "in furtherance of a common defense."[9] Although applicable in criminal cases, this limitation is not pertinent to situations like *Ambac*, where legal advice was sought in a transactional setting for the purpose of complying with the legal and regulatory requirements inherent in closing the merger.

Applying these principles to the discovery dispute at issue in *Ambac*, the Court held that the common-interest privilege could apply to pre-closing communications between Bank of America and Countrywide and their counsel because the parties (a) signed a merger agreement, (b) signed a confidentiality agreement governing pre-closing exchanges of information, and (c) needed shared advice of counsel "in order to accurately navigate the complex legal and regulatory process involved in completing the transaction."[10]

IMPLICATIONS

The First Department's decision potentially brings New York law in line with the prevailing treatment of the common-interest privilege in federal courts and in Delaware by protecting from disclosure legal advice shared among multiple parties to further a "common legal interest" unrelated to pending or anticipated litigation. The decision, however, is not of New York's highest court and is subject to appeal (although the Court of Appeals has discretion as to whether to hear an appeal). In addition, although *Ambac* is controlling in the First Department (which includes cases filed in Manhattan), it might not be controlling elsewhere, especially as the Second Department (which covers ten counties, including Kings (Brooklyn) and Queens) has held as recently as last year that the common-interest privilege requires "reasonable anticipation of litigation."[11]

The decision also leaves open a number of questions:

- *Ambac* does not directly address whether the common-interest privilege can apply to communications shared with parties other than the transaction parties and their counsel – for example, the investment bankers of the merging entities. The court does, however, state that it was "guided by Delaware's approach to the common-interest privilege."[12] Although courts in some jurisdictions have held that the presence of investment bankers breaks the privilege because they are not "'necessary' for the

'effective consultation' between client and attorney," Delaware law "sanctions the privilege's application to attorney-client communications including an investment banker, especially within the context of a pending transaction."[13]

- *Ambac* addresses the application of the common-interest privilege to the sharing of communications after execution of a merger agreement, but does not address whether the common-interest privilege could also apply prior to the execution of a merger agreement (for example, to privileged communications shared during a due diligence process). Some courts have declined to apply the common-interest privilege to communications shared in due diligence prior to entry into a merger agreement, finding that the parties' interests at that point are not sufficiently aligned.[14] Nevertheless, other courts have been willing to extend the privilege to cover communications shared with prospective buyers, particularly with respect to communications about potential post-acquisition litigation.[15]

- The decision does not address who retains control over pre-merger communications protected by the common-interest privilege after the close of the merger. The general rule is that rights to privileged communications pass to the purchaser upon the close of a merger.[16] The seller thus risks losing any control over communications subject to the common-interest privilege after the close of the 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, and selling parties might wish to carefully delineate those rights even in the absence of specific guidance from New York courts.[17]

- The First Department in *Ambac* remanded to the Commercial Division to apply its decision to the documents at issue. Questions of whether the common-interest privilege can apply, or if it applies to particular documents, are necessarily context-specific, and transaction parties should consult counsel for specific advice. Based on *Ambac* and other authorities, however, taking certain steps might be helpful in preserving the ability to assert the common-interest privilege, including:

    - *Contemporaneous documentation*. The *Ambac* Court took particular note of the fact that the parties had signed both a merger agreement and a confidentiality agreement. Contemporaneous documentation of the basis for the common-interest privilege and the parties' intent to preserve it can often be more persuasive to courts than explanations provided after the privileged communications have been shared.

    - *Confidentiality*. Communications are generally not privileged unless kept confidential between the attorney and client, and *Ambac* referenced the parties' confidentiality agreement in reaching its decision. Transaction parties might bolster their ability to invoke the common-interest privilege by such measures as executing confidentiality agreements, limiting the individuals receiving the communications to those strictly necessary, placing time limits on the ability to access the communications, and placing constraints on distribution (*e.g.*, prohibiting copying or forwarding of the communications, or requiring that the privileged communications be reviewed in a facility with limited access).[18]

    - *Limitation to common legal interests*. Courts addressing the common-interest doctrine frequently assess whether the interest being furthered was a "legal" or "business" interest, and have held that merely furthering common business interests does not invoke the protections of the doctrine. *Ambac* noted that the doctrine would not apply to "advice of a predominately business nature,"[19] but found a common legal interest in advice on how "to accurately navigate the complex legal and regulatory process involved in completing the transaction."[20] Transaction parties might strengthen their common-interest privilege claims by contemporaneously documenting the legal interest that is to be furthered, by advising transaction participants to segregate their privileged communications from more general business communications, and by limiting those privy to the privileged communications to counsel and others necessary to furthering the common legal interest.

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ENDNOTES

[1] Index No. 651612/10 (1st Dep't Dec. 4, 2014).

[2] *Id*., slip op. at 4.

[3] *Ambac Assurance Corp.* v. *Countrywide Home Loans, Inc.*, 2013 WL 5629595, at *1-2 (Sup. Ct., N.Y. Cnty. Oct. 16, 2013).

[4] *Ambac Assurance Corp.*, Index No. 651612/10, slip op. at 2.

[5] *Id.* at 7 (quoting *Upjohn Co.* v. *United States*, 449 U.S. 383, 389 (1981)).

[6] *Id.* at 7-8 (quoting *Spectrum Sys. Int'l Corp.* v. *Chem. Bank*, 78 N.Y.2d 371, 380 (1991)).

[7] *Id.* at 8 (quoting *United States* v. *BDO Seidman, LLP*, 492 F.3d 806, 816 (7th Cir. 2007)).

[8] *Id.* at 11 (citing *Hyatt* v. *State of Cal. Franchise Tax Bd.*, 105 A.D.3d 186, 205 (2d Dep't 2013); *Hudson Valley Marine, Inc.* v. *Town of Cortlandt*, 30 A.D.3d 377, 378 (2d Dep't 2006); *Aetna Cas. & Sur. Co.* v. *Certain Underwriters at Lloyd's, London*, 176 Misc. 2d 605, 612-13 (Sup. Ct., N.Y. Cnty. 1998); *Allied Irish Banks, P.L.C.* v. *Bank of Am. N.A.*, 252 F.R.D. 163, 171-72 (S.D.N.Y. 2008)).

[9] *Id.* at 12-13 (quoting *Parisi* v. *Leppard*, 172 Misc. 2d 951, 955 (Sup. Ct., Nassau Cnty. 1997)).

[10] *Id*. at 14.

[11] *Hyatt*, 105 A.D.3d at 205; *see also Hudson Valley Marine*, 30 A.D.3d at 378.

[12] *Ambac Assurance Corp.*, Index No. 651612/10, slip op. at 14.

[13] *3Com Corp.* v. *Diamond II Holdings, Inc.*, 2010 WL 2280734, at *4-5 & n.18 (Del. Ch. May 31, 2010) (quoting *Comm'r of Revenue* v. *Comcast*, 901 N.E.2d 1185, 1197 (Mass. 2009)); *cf. Blanchard* v. *EdgeMark Fin. Corp.*, 192 F.R.D. 233, 237 (N.D. Ill. 2000) (common-interest privilege does not apply to document sent to investment banker whose "legal interests were [not] threatened in a meaningful way").

[14] *See, e.g.*, *In re JP Morgan Chase & Co. Sec. Litig.*, 2007 WL 2363311, at *5 (N.D. Ill. Aug. 13, 2007) (declining to apply common-interest privilege because the court "does not understand how [the parties] can be said to share a common legal interest prior to their signing the merger").

[15] *See, e.g.*, *Nidec Corp.* v. *Victor Co. of Japan*, 249 F.R.D. 575, 579 (N.D. Cal. 2007) (citing cases).

[16] *See CFTC* v. *Weintraub*, 471 U.S. 343, 349 (1985).

[17] *See Great Hill Equity Partners IV, LP* v. *SIG Growth Equity Fund I, LLLP*, 80 A.3d 155, 161 (Del. Ch. 2013) (advising parties "to use their contractual freedom . . . to exclude from the transferred assets the attorney-client communications they wish to retain as their own").

[18] *See*, *e.g.*, *Tenneco Packaging Specialty & Consumer Prods., Inc*. v. *S.C. Johnson & Son*, *Inc*., 1999 WL 754748, at *2 (N.D. Ill. Sept. 14, 1999) (upholding assertion of common-interest privilege where disclosing party "took substantial steps to ensure that the opinion would remain confidential," including disclosing the privileged communication only to a limited number of individuals, each of whom agreed to abide by the confidentiality agreement).

[19] *Ambac Assurance Corp.*, Index No. 651612/10, slip op. at 11.

[20] *Id*. at 14.

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