

# The *Ambac* Decision and the Future of the Common Interest Privilege Under New York Law

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Commercial lawyers and their clients now need to be more vigilant when sharing privileged communications with third parties in business or transactional settings where there is no reasonably anticipated or pending litigation. In June 2016, the New York Court of Appeals issued an important decision narrowing the scope of New York's common interest doctrine, an exception to the traditional rule that a third party's exposure to attorney-client communications voids the attorney-client privilege.

The common interest privilege, as it is also called, is designed to preserve the privileged status of attorney-client communications shared with others who have a common legal interest with the client. In modern legal practice, the doctrine has often been applied in commercial transactions, such as mergers and acquisitions, to

cal implications of the *Ambac II* decision and the growing interest in and possibility of the New York legislature codifying and modifying the common interest privilege to cover non-litigation, commercial transactions.

## The Origins of the Attorney-Client Privilege and Common Interest Privilege

The origins of the attorney-client privilege date back to English common law, where it was considered an essential tool to facilitate open and honest dialogue between lawyers and their clients. Armed with the assurance that their communications with counsel would remain confidential, the privilege allowed clients to freely converse with their attorneys without fear of retribution, and, in theory, the clients would share more information than they would without the privilege. This open channel of communication en-

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enable individuals and entities with aligning interests to coordinate their positions without waiving the privileged status of their communications with counsel. In several state and federal jurisdictions across the country and in the Restatement (Third) of the Law Governing Lawyers, a “common legal interest” and “communication in furtherance of that interest” between the client and third party are the doctrine's only prerequisites. Until June of last year, the elements of the privilege under New York law were unclear; while the Appellate Division, Second Department and other New York trial courts also imposed a litigation requirement for the privilege to apply—i.e., that there be a pending or reasonably anticipated litigation—the First Department rejected the litigation requirement and adopted the same standard applied by many federal jurisdictions and the Restatement.<sup>1</sup> In *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*,<sup>2</sup> the New York Court of Appeals eliminated the ambiguity under New York law, holding there must be a pending or reasonably anticipated litigation for the common interest doctrine to apply.

While *Ambac II*'s first anniversary is quickly approaching, transactional lawyers and litigators continue to grapple with the uncertainty left in its wake. This article will discuss the history and evolution of the attorney-client privilege and common interest doctrine, the practi-

cal implications of the *Ambac II* decision and the growing interest in and possibility of the New York legislature codifying and modifying the common interest privilege to cover non-litigation, commercial transactions.

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American law and is recognized by all state and federal courts in the United States.

Despite its critical role in the facilitation of sound legal representation, the attorney-client privilege runs contrary to the prevailing preference in American law for openness through liberal discovery. As a result, courts generally construe the privilege narrowly in order to safeguard the public's interest in "the truth-finding process."<sup>6</sup> To that end, the presence of a third party or the disclosure of an otherwise privileged communication to a third party after the fact generally results in the waiver of the privilege.

Since the attorney-client privilege's formal debut in *Hunt v. Blackburn*, however, a handful of exceptions to this general "waiver" rule have emerged. One such exception is known as the joint defense privilege, which applies when co-defendants and their counsel in a single or related litigations engage in communications concerning a joint defense strategy. This concept actually predates the United States Supreme Court's first recognition of the attorney-client privilege in *Hunt*. Indeed, about a decade earlier, in *Chahoon v. Commonwealth*,<sup>7</sup> the Virginia Supreme Court held that a criminal defendant did not waive the attorney-client privilege by sharing confidential information with his co-defendants' attorneys. In the court's view, there was no meaningful difference between three defendants being represented by a single attorney and three defendants being represented by separate attorneys: "[T]he counsel of each was in effect the counsel of all."<sup>8</sup> The court concluded that extending confidentiality to communications among co-defendants with a common defense strategy advanced the two overarching goals of the attorney-client privilege—fostering open communication and enhancing the quality of legal counsel.<sup>9</sup>

Slowly but surely, the joint defense privilege crept into the civil arena. In 1942, in *Schmitt v. Emery*, the Minnesota Supreme Court applied the same principles employed by the Virginia Supreme Court nearly seven decades earlier in *Chahoon* and held that co-defendants in a personal injury case did not waive the attorney-client privilege by openly discussing the details of the case in the presence of each other's lawyers.<sup>10</sup> The court reasoned that the privilege should apply because the attorneys were "engaged in maintaining substantially the same cause on behalf of other parties in the same litigation."<sup>11</sup>

A descendant of the joint defense privilege, the common interest doctrine developed as yet another exception to the traditional rule that the presence of a third party waives the attorney-client privilege and effectively extended the reach of the joint defense privilege.<sup>12</sup> While the joint defense privilege applied to disclosures made among co-parties and their lawyers on the same side of a pending litigation, the common interest doctrine was intended to apply to confidential disclosures made to third parties, which are represented by separate counsel and share any common legal interest (litigation or transaction)

with the client when those disclosures are made in furtherance of that common legal interest.<sup>13</sup> Indeed, the common interest privilege is broadly defined in the Restatement (Third) of the Law Governing Lawyers:

If two or more clients with a common interest in a litigated or nonlitigated matter are represented by separate lawyers and they agree to exchange information concerning the matter, a communication of any such client that otherwise qualifies as privilege . . . that relates to the matter is privileged as against third persons.<sup>14</sup>

As the doctrine's recognition grew in the second half of the 20th Century, many state and federal courts adopted the expansive view of the common interest privilege set forth in the Restatement and applied the privilege in litigation and non-litigation settings.<sup>15</sup> Under this expansive approach of the common interest doctrine, not only could co-defendants and co-plaintiffs share legal strategies amongst themselves without waiving the privilege, a corporation interested into acquiring another could review otherwise privileged communications and strategies of a target corporation when both corporations had a "common interest" in merging, without risking waiver of the attorney-client privilege and disclosure.

New York, however, did not immediately embrace the common interest doctrine with such open arms, and declined to adopt the Restatement's definition. The first time the New York Court of Appeals even addressed the common interest privilege was in *People v. Osario*, when it refused to extend the common interest privilege protection to communications between an attorney and two separately represented co-defendants where one co-defendant was acting as the other's language interpreter.<sup>16</sup> While this appeared to be a significant departure from the principles established by the courts in *Chahoon* and *Kovel*, the critical difference in *Osario*, according to the Court of Appeals, was that the interpreter's exposure to the confidential dialogue between his co-defendant and the co-defendant's attorney was *unrelated* to his own defense. As a result, the Court ruled that there was no common interest, and the communication was not privileged.<sup>17</sup>

Even as New York courts began to apply the common interest privilege in the civil context following *Osario*, they proceeded cautiously and applied the privilege as a narrow exception to the traditional rule of waiver of the attorney-client privilege. One way the New York courts limited the scope of the common interest privilege was to require that any shared interest between clients be "identical" (or nearly identical) as opposed to merely similar.<sup>18</sup> In addition, many New York courts imposed a "litigation requirement" to the doctrine, providing that parties must face pending or reasonably anticipated litigation for the privilege to apply to communications made in furtherance of a common legal interest.<sup>19</sup>

## The First Department Changes Course and Adopts a Broader Application of the Common Interest Privilege

In 2014, in a unanimous decision, the Appellate Division, First Department, in *Ambac I* broke with the rulings of the Second Department and other New York State trial courts and eliminated the litigation requirement to application of the common interest privilege.

*Ambac I* concerned a merger transaction between Bank of America (“BoA”) and Countrywide Home Loans (“Countrywide”) wherein Countrywide merged into a wholly owned subsidiary of BoA in 2008. As part of the transaction, the parties entered into a merger agreement and written common interest agreement to facilitate their negotiations on various pre-closing aspects of the deal, and exchanged certain privileged communications relating to their pre-closing obligations.

In 2010, when some residential mortgage-backed securities issued by Countrywide and insured by Ambac failed, Ambac filed suit against Countrywide, which it claimed had fraudulently misrepresented the quality of the mortgage loans, and against BoA, as Countrywide’s successor-in-interest following the merger. During discovery, Ambac sought the disclosure of the “pre-closing communications” between Countrywide and BoA, which BoA and Countrywide refused to produce on the grounds that they were protected by the common interest privilege. Ambac, in turn, argued that the voluntary sharing of such privileged communications before the closing of the merger waived any attorney-client privilege because BoA’s and Countrywide’s common legal interest did not relate to any pending or reasonably anticipated litigation. On Ambac’s motion to compel, a special referee held that, despite the parties’ written common interest agreement, the common interest privilege did not protect the parties’ communications because at the time the communications occurred, there was no litigation pending or reasonably anticipated. BoA then moved to vacate the special referee’s order, but the trial court denied the motion.

On appeal, the First Department reversed the trial court’s decision, and held that the common interest privilege could apply to pre-closing communications regardless of the presence of a pending or reasonably anticipated litigation.<sup>20</sup> While the court cited several factors that influenced its decision, perhaps most persuasive was the court’s observation that the attorney-client privilege—in which the common interest privilege has its roots—can be invoked in both litigation and non-litigation contexts.<sup>21</sup> In fact, “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.”<sup>22</sup> The court reasoned that highly regulated businesses like BoA and Countrywide routinely consult with counsel to navigate “the vast and complicated array of regulatory legislation” even in the absence of litigation.<sup>23</sup> In addition, the court recognized that the Restatement’s version of the common interest privilege lacks a litigation requirement.<sup>24</sup>

Moreover, the court cited to a series of federal decisions which, as the First Department put it, had “overwhelmingly rejected a litigation requirement,” and to Delaware law which codified the common interest exception so as to apply to non-litigation circumstances.<sup>25</sup> Finally, the court rejected the line of New York cases that required the litigation element, stating that such an element did not adequately address the situation at issue—where two entities had entered into a merger agreement and common interest agreement and required the shared advice of counsel to “navigate the complex legal and regulatory process involved in the transaction.”<sup>26</sup>

This decision caused a split between the First and Second Departments of the Appellate Division, which ultimately landed the issue before the New York Court of Appeals.

## The Court of Appeals Restores the “Litigation Requirement”

In June 2016, the New York Court of Appeals reversed the First Department’s holding in *Ambac I* and, in a lengthy 4-2 decision, held that the common interest privilege only applies if a pending or reasonably anticipated litigation exists at the time of the communication.<sup>27</sup> Tracing the lineage of the common interest privilege to its origins in criminal law, and concluding that the removal of the litigation requirement increased the risk of abuse, the Court of Appeals reinstated the order of the trial court, which held that communications made outside the context of a pending or anticipated litigation were not privileged.

In rejecting the more expansive application of the common interest privilege, the Court of Appeals reasoned that it should be limited to “situations where the benefit and the necessity of shared communications are at their highest, and the potential for misuse is minimal.”<sup>28</sup> For example, when litigation is pending or imminent, “the threat of mandatory disclosure may chill the parties’ exchange of privileged information and therefore thwart any desire to coordinate legal strategy.”<sup>29</sup> By contrast, the Court reasoned that “the same cannot be said of clients who share a common legal interest in a commercial transaction” in that they have an incentive to close the transaction and, moreover, because there is a “greater danger that the underlying communications will be for a commercial purpose rather than for securing legal advice.”<sup>30</sup>

The Court of Appeals also rejected BoA’s argument that the failure to adopt the broader interpretation of the common interest privilege would have adverse policy consequences for the State of New York. Specifically, the Court disagreed with BoA’s assertion that companies would conduct their transactions in other jurisdictions because of New York’s narrow common interest privilege. “There is no evidence,” the Court opined, “that mergers, licensing agreements and other complex commercial transactions have not occurred in New York because of our State’s liti-

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gation limitation on the common interest doctrine; nor is there evidence that corporate clients will cease complying with the law.”<sup>31</sup> As an additional reason for rejecting the expansion of the common interest privilege, the Court stated that a broader exception “could result in the loss of evidence of a wide range of communications between parties who assert common legal interests but who really have only non-legal or exclusively business interests to protect.”<sup>32</sup> The Court of Appeals ultimately concluded that the policy reasons for keeping a litigation requirement on the common interest doctrine outweighed any purported justification for doing away with it, but nevertheless acknowledged that the “legislature is free. . . to expand the common interest exception as other state legislatures have done (see e.g. Del. Rules Evid. rule 502 [b]).”<sup>33</sup>

## The Implications of *Ambac* and a Potential Legislative Modification

In light of the Court of Appeal’s ruling in *Ambac II*, parties to commercial transactions and their lawyers, particularly in mergers and acquisitions, should be wary of sharing privileged communications and work product with third parties or their attorneys in the absence of pending or reasonably anticipated litigation even if those communications concern a common legal interest. A few options parties may consider under these circumstances are to (1) avoid sharing confidential and privileged pre-closing information altogether to circumvent the discovery risk; (2) obtain special joint counsel to represent both the parties in such transactions through which privileged information can be exchanged and shielded from disclosure;<sup>34</sup> or (3) separate legal communications from business communications, and share due diligence on a transaction that arguably relates to reasonably anticipated litigation while redacting or segregating out non-litigation business communications during the due diligence or negotiation process.

The implication of the first option is that parties to commercial transactions may ultimately provide incomplete or inaccurate public disclosure during the due diligence stage, thereby creating a greater risk of potential litigation and liability. Judge Jenny Rivera recognized this risk in her dissent in *Ambac II*, stating that, “Given that the attorney-client privilege has no litigation requirement and the reality that *clients often seek legal advice specifically to comply with legal and regulatory mandates and avoid litigation or liability*, the privilege should apply to private client-attorney communications exchanged during the course of a transformative business enterprise, in which the parties commit to collaboration and exchange of client information to obtain legal advice aimed at compliance with transaction-related statutory and regulatory mandates.”<sup>35</sup> The Appellate Division, First Department, in *Ambac I* similarly raised these concerns, opining that

“imposing a litigation requirement. . . discourages parties with a shared legal interest, such as the signed merger agreement here, from seeking and sharing that 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.”<sup>36</sup>

Although the New York Court of Appeals insisted in *Ambac II* that New York’s litigation requirement would not deter commercial transactions from taking place in the state, many practitioners and legal commentators remain unconvinced and are putting pressure on the New York legislature to craft a common interest privilege exception that continues to maintain New York’s status as a commercially viable and desirable venue for sound business practices. To that end, both the dissent in *Ambac II* and some practitioners have recommended that the New York legislature adopt a narrow expansion to the common interest doctrine to cover communications made in commercial transactions in furtherance of or related to compliance with statutory or regulatory requirements.<sup>37</sup> Judge Rivera’s dissent in *Ambac II* specifically advocated for such an approach, noting that:

[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. This application of the privilege functions as a narrowly crafted exception to third-party waivers in the merger context, and is justified because signatories to a pre-merger agreement are bound with a common interest in completion of the merger.<sup>38</sup>

Judge Rivera further noted that this approach “would maximize the quality of disclosure necessary for accurate and competent representation leading to compliance with regulatory and legal mandates” and would encourage “parties committed to a merger to disclose confidential information to avoid submission of incomplete or noncompliant documents.”<sup>39</sup> In other words, without some legislative expansion, some practitioners and commentators believe that the majority’s opinion in *Ambac II* may have a chilling effect on the quality and quantity of disclosure made by parties in commercial transactions to their counterparties, investors and regulators.<sup>40</sup>

Perhaps anticipating some backlash from the transactional bar, the Court of Appeals expressly raised the prospect of New York following in Delaware’s footsteps and codifying a more expansive common interest privilege.<sup>41</sup>

Delaware, like New York, has a favorable corporate regulatory landscape, making the state a perennial favorite for jurisdictional clauses and choice of law provisions in commercial agreements. Recognizing the value that the common interest doctrine adds to the complex legal and regulatory processes involved in corporate transactions, Delaware codified the common interest privilege specifically to ensure its applicability in non-litigation, commercial settings.<sup>42</sup>

With increasing pressure from the transactional bar, it appears likely that the New York legislature may be compelled to codify a non-litigation version of the common interest privilege to supersede *Ambac II* in the near future, similar to what Delaware has done. All this remains to be seen as clients, attorneys and the courts continue to navigate the landscape of the common interest doctrine in the coming months and years.

## Conclusion

Absent some legislative modification, the New York Court of Appeals in *Ambac II* made clear that the common interest doctrine applies under New York law only if the following three elements are met: (1) the parties share a common interest; (2) the communications are made in furtherance of the common legal interest; and (3) the communications relate to a pending or reasonably anticipated litigation.

## Endnotes

1. See *Assur. Corp. v. Countrywide Home Loans, Inc.*, 124 A.D.3d 129, 135-36 (1st Dep't 2014) ("*Ambac I*").
2. 27 N.Y.3d 616 (2016) ("*Ambac II*").
3. See, e.g., *Hunt v. Blackburn*, 128 U.S. 470 (1888); *Chahoon v. Commonwealth*, 62 Va. (21 Gratt.) 822 (1871).
4. 128 U.S. 470 (1888).
5. 449 U.S. 383, 390 (1981). See Matthew D. LaBrie, *The Common Interest Privilege*, ABA Section of Litigation (Sep. 30, 2014).
6. *In re Jacqueline F.*, 47 N.Y.2d 215, 219 (1979).
7. 62 Va. (21 Gratt.) 822, 841-42 (1871).
8. *Id.* at 841.
9. *Id.* at 841-42.
10. 2 N.W.2d 413 (Minn. 1942).
11. *Id.* at 417. Another exception to the general third-party waiver rule is known as the *Kovel* privilege. In *United States v. Kovel*, the United States Court of Appeals for the Second Circuit held that the work-product of an accountant was protected by the attorney-client privilege where the accountant had specifically been retained by the attorney in response to criminal tax charges brought against the client. 296 F.2d 918 (2d Cir. 1961). The Second Circuit compared the role of the accountant to an interpreter facilitating communications between a lawyer and a non-English speaking client, and stated that the accountant's work was essential for "effective consultation" and analysis of the client's legal position. Therefore, communications by and between agents of an attorney or client related to the underlying legal representation where the agent has been retained to assist the attorney in providing legal advice are generally afforded privileged status.
12. See LaBrie, *The Common Interest Privilege*, ABA Section of Litigation, at 2-3.

13. See Restatement (Third) of the Law of Governing Lawyers § 76.
14. *Id.*
15. See, e.g., *U.S. v. Schwimmer*, 892 F.2d 237, 243 (2d Cir. 1989); *U.S. v. Zolin*, 809 F.2d 1411, 1417 (9th Cir. 1987); *In re Regents of Univ. of Cal.*, 101 F.3d 1386, 1390-1391 (Fed. Cir. 1996); *In re Teleglobe Comm'ns*, 493 F.3d 345, 364 (3d Cir. 2007); *United States v. BDO Seidman, LLP*, 492 F.3d 806, 816 (7th Cir. 2007); *Hanover Ins. Co. v. Rapo & Jepsen Ins. Servs.*, 870 N.E.2d 1105, 1110, 1112 (Mass. 2007) and *3Com Corp. v. Diamond II Holdings, Inc.*, No. 3933-VCN, 2010 WL 2280734, at \*6-8 (Del. Ch. May 31, 2010) (adopting narrower scope than the Restatement, but not requiring a litigation element).
16. 75 N.Y.2d 80 (1989).
17. *Id.* at 85.
18. *Hyatt v. State of Cal. Franchise Tax Bd.*, 105 A.D.3d 186, 205 (2d Dep't 2013).
19. See, e.g., *Hyatt*, 105 A.D.3d at 205; *Hudson Val. Mar., Inc. v. Town of Cortlandt*, 30 A.D.3d 377, 378 (2d Dep't 2006); *Stenovich v. Wachtell, Lipton, Rosen & Katz*, 195 Misc. 2d 99, 108 (Sup. Ct. NY County 2003); *Yemini v. Goldberg*, 12 Misc. 3d 1114 (Sup. Ct. Nassau County 2006); *Aetna Cas. & Sur. Co. v. Certain Underwriters at Lloyd's, London*, 176 Misc.2d 605, 611-12 (Sup.Ct. N.Y. County 1998), *aff'd*, 263 A.D.2d 367 (1st Dep't 1999).
20. *Ambac I*, 124 A.D.3d at 331.
21. *Id.* at 333.
22. *Id.*
23. *Id.* (quoting *Upjohn Co.*, 449 U.S. at 392).
24. *Id.*
25. *Id.* at 333-34.
26. *Id.* at 334-35.
27. *Ambac II*, 27 N.Y.3d at 616.
28. *Id.* at 627.
29. *Id.* at 628.
30. *Id.* at 629.
31. *Id.* at 628.
32. *Id.* at 629.
33. *Id.* at 631, and n.6.
34. The *Ambac II* decision expressly acknowledges that communications among parties represented by the same attorney in merger transactions would be protected from disclosure by the common interest doctrine, because joint clients "indisputably share a complete alignment of interests" and that "all joint communications will be in furtherance of that joint representation." *Ambac II*, 27 N.Y.3d at 630-31.
35. *Ambac II*, 27 N.Y.3d at 633.
36. *Ambac I*, 124 A.D.3d at 137.
37. See *Ambac II*, 27 N.Y.3d 637; see also Steward D. Aaron, Joshua Berick & Christian D. Cheslak, *Preserving Attorney-Client Privilege in M&A Transactions*, New York Law Journal (Aug. 8, 2016).
38. *Ambac II*, 27 N.Y.3d 637.
39. The U.S. Chamber of Commerce and the Association of Corporate Counsel submitted an amicus brief in the Court of Appeals arguing that "limiting the common-interest privilege to situation of anticipated litigation will discourage businesses from obtaining and sharing legal advice that enables them to comply with the law."
40. See Aaron, *Preserving Attorney-Client Privilege in M&A Transactions*, *supra*.
41. *Ambac II*, 27 N.Y.3d at 632, n. 6.
42. Del. Rule of Evidence 502(b).