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Be Careful What You Share Pre-Merger With Your Deal Partner

This article provides a discussion of the current legal landscape surrounding document sharing during the pre-merger stage of a merger transaction.

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It is routinely the case that, following entry into an agreement of merger, two merging entities will share documents as part of their overall due-diligence process to effectuate the ultimate closing of the merger. Such shared materials can include sensitive documents relating to pending or anticipated litigation involving the company that is being acquired in the merger, which begs the question of whether, in subsequent litigation, a third party, such as the individual or entity with which the target company had anticipated litigation, may obtain discovery of the materials that were shared between the merging entities prior to the merger.

One way that merging entities have endeavored to shield such documents from production in subsequent litigation is under the common interest doctrine. But recent court decisions suggest that, under New York law, the common interest doctrine may be insufficient to protect such documents from disclosure in the merger context, a risk which corporate attorneys would do well to consider as they contemplate the documents they share with their counterparties in the merger context.

The attorney-client privilege "shields from disclosure any confidential communications between an attorney and his or her client made for the purposes of obtaining or facilitating legal advice in the course of a professional relationship." *Ambac Assurance v. Countrywide Home Loans*, 27 N.Y.3d 616, 624 (2016).

The privilege is "narrowly construed," however, and it is generally waived when privileged documents are shared with third parties. Id. The common interest doctrine is an exception to the waiver which would ordinarily occur when privileged documents are shared with third parties, which shields communications made between parties with "a common legal interest" where the communications are "made in furtherance of that common interest" and "also relate to litigation." Id. at 620.

The litigation requirement is critical. In *Ambac*, the Court of Appeals concluded that documents shared pre-merger between merging entities were not privileged because they did not relate to pending or reasonably anticipated litigation. Id. at 628-32. Accordingly, under the holding of *Ambac*, notwithstanding that merging parties may be aligned in interest and that the merger may ultimately make the acquiring party the real party in interest, in the absence of pending or reasonably anticipated litigation, any privileged communications shared between merging entities may be discoverable by third-parties in subsequent litigation. Id.

The rationale behind this ruling is that parties intent on closing a business deal, such as a merger, would share privileged documents regardless of privilege waiver to facilitate the closing of their business deal. Id. at 629, citing Melanie B. Leslie, *The Cost of Confidentiality and the Purpose of Privilege*, 2000 Wis. L. Rev. 31, 68 (2000). But query whether they would *knowingly* do so?


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Ambac confirms that litigation is reasonably anticipated, for purposes of the common interest doctrine, where the parties who have shared privileged materials are "codefendants, coplaintiffs or persons who reasonably anticipate that they will become colitigants …," and that litigation is not reasonably anticipated when such parties merely "share a common legal interest in a commercial transaction or other common problem." *Ambac*, 27 N.Y.3d at 628.

It therefore matters tremendously what counts as pending or reasonably anticipated litigation, after *Ambac*, and whether, as the *Ambac* dissent concluded, the "colitigant" standard is the "sole[]" scenario in which, under the majority's holding, "the common interest doctrine should apply …." Id. at 636. For example, when Company A buys Company B, knowing that Company B is engaged in or soon will be engaged in litigation, is that knowledge sufficient to constitute a common legal interest in pending or reasonably anticipated litigation such that privileged documents shared by Company B with Company A can be withheld under the common interest doctrine? While

many practitioners might assume the answer is "yes," a recent post-*Ambac* decision by the Appellate Division, First Department confirms that the answer in fact may likely be "no."

Indeed, if "colitigants" is the standard for reasonable anticipation of litigation, as outlined by the Court of Appeals in *Ambac*, then it is insufficient for Company A to merely expect to take on Company B's pending or anticipated litigation as a going concern upon consummation of the merger in order for the common interest doctrine to apply. Rather, in the words of the *Ambac* majority, for documents shared pre-merger between Company A and Company B to be shielded from subsequent disclosure under the common interest doctrine, Company A must have anticipated, at the time the documents were shared, that it would become a "codefendant[], coplaintiff[] … or colitigant[]" with Company B in such pending or reasonably anticipated litigation. *Ambac*, 27 N.Y.3d at 628. But if Company B's pending or anticipated litigation relates to a contract, there would presumably be no basis on which such litigation could have been pending or anticipated by Company A, a non-party to the contract, making the shared documents discoverable. Such was the case in *Telx-New York v. 60 Hudson Owner*, 174 A.D.3d. 435 (1st Dep't 2019).

In 2015 Telx-New York (Telx) was acquired by Digital Realty Trust (Digital). See *Telx-New York v. 60 Hudson Owner*, 2019 WL 333037, at *1-2 (Sup. Ct. N.Y. Cty. Jan. 24, 2019). At issue before the Appellate Division, First Department was whether certain documents which Telx had shared with Digital pre-merger were discoverable in subsequent litigation between Telx and its commercial landlord.

Unlike in *Ambac*, Telx claimed that it had contemplated litigation with its landlord at the time of its merger with Digital, and that the withheld documents related to the contemplated litigation. The critical issue was accordingly whether it was sufficient for Digital to have contemplated, at the time the documents were shared, that *Telx* would be engaged in litigation, or whether, under *Ambac*, Digital was required to have contemplated, *itself*, being a party to any litigation between Telx and its landlord at the time the confidential materials were shared—an impossibility given that the contemplated dispute related to the parties' lease, to which Digital was not a party.

The Supreme Court had ordered Telx to produce the documents it had shared with Digital prior to the closing of their merger, and the Appellate Division affirmed, because the documents did not relate to reasonably anticipated litigation but instead were, in the words of the Appellate Division, documents relating only to Telx's and Digital's "collaborat[ion] to promote their common interest in closing a merger transaction." *Telx*, 174 A.D.3d. at 436.

Notably, Digital could not have anticipated being a colitigant in anticipated litigation between Telx and the landlord, because it was not a party to the contract (i.e., the lease) under which such litigation arose, as a result of which, as the Supreme Court aptly noted, the documents in question did not show "a belief that in 2015 Telx *and Digital* were on a path to litigation with the landlord." *Telx-New York v. 60 Hudson Owner*, 2019 WL 333037, at *2 (Sup. Ct. N.Y. Cty. Jan. 23, 2019) (emphasis added).

In short, in the scenario outlined above, where target Company B shares with acquiring Company A documents relating to pending or anticipated litigation with another party as part of the due diligence process for closing the parties' merger, in which litigation Company A does not stand to become a colitigant, the documents are discoverable in subsequent litigation, *including in the very litigation that Company B had anticipated*.

This begs the question of what, if anything, merging parties can do to safeguard such communications from discovery in the wake of *Ambac* and *Telx*. In *Telx*, the plaintiff and Digital had entered into a cooperation agreement, but they had not entered into a "common interest agreement," pursuant to which they specifically agreed that the documents they shared pre-merger were privileged and thus protected from disclosure or discovery in subsequent litigation. See *Telx-New York v. 60 Hudson Owner*, Brief for Plaintiff-Appellant, 2019 WL 2881462, at *15-16.

Whether entering into a "common interest agreement" would have been sufficient to shield the documents in *Telx* from production is unclear. Certainly, in *Kindred Healthcare v. SAI Global Compliance*, 169 A.D.3d 517 (1st Dep't 2019), the parties' entry into a "common interest agreement" was sufficient to shield documents shared with potential merger partners from production, but litigation was actually pending in *Kindred* (id.), unlike in *Telx*, where there was no litigation pending at the time the documents were shared. *Telx*, 174 A.D.3d at 436.

In light of the foregoing developments, it is apparent that documents shared pre-merger between merging entities, including those relating to pending or anticipated litigation, are discoverable in subsequent litigation if the merging parties do not each, themselves, anticipate being parties to litigation when the documents are shared and the documents do not relate to such pending or anticipated litigation.

And while a so-called "common interest agreement" may offer some degree of protection, the prudent practitioner should be aware of these legal developments and be extremely cautious about sharing privileged documents with his or her counterparty in a merger transaction, as such documents could well be discovered and used by an adversary in subsequent litigation.

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