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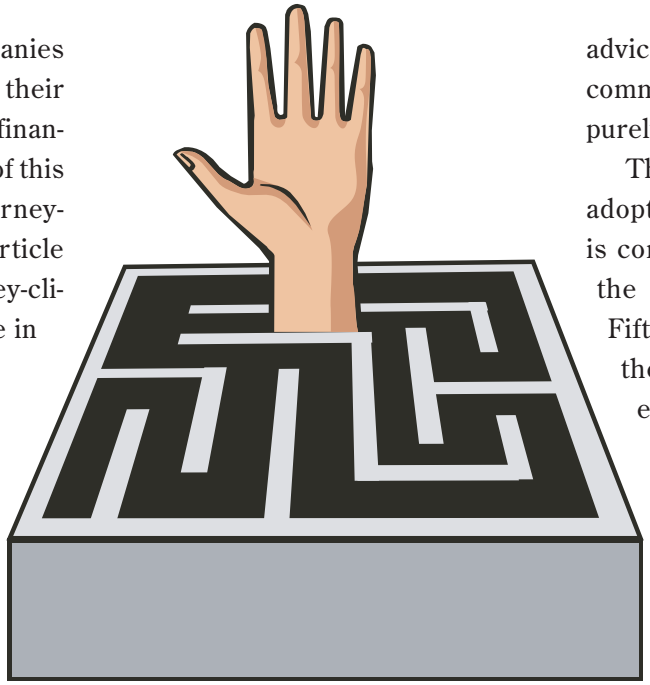
Attorney-Client Privilege Issues in M&A Work

BY ROBERT B. LITTLE



In M&A transactions, companies disclose sensitive information to their transaction counterparties and financial advisors, and the disclosure of this information often implicates attorney-client privilege issues. This article addresses two common attorney-client privilege questions that arise in M&A transactions.

1. Does the disclosure of attorney-client privileged information to transaction counterparties during due diligence and negotiations waive the privilege? It is common for a purchaser, in the course of its due diligence, to request information from the seller to assess the litigation, compliance or regulatory risks of the acquisition. Because the attorney-client privilege is usually waived when a communication is disclosed to a third party, the seller often is reluctant to provide privileged information to the purchaser. However, without sharing of information, the purchaser may decline to go forward with the deal.

The common interest doctrine, which preserves the privilege with respect to communications among parties and their attorneys that have a shared legal interest, can address this problem. Some courts have held that the common interest doctrine applies only when two or more clients participate in joint attorney-client discussions for the purpose of preparing a common litigation defense. Other courts have held that the common interest doctrine protects information shared by parties to a purchase agreement prior to closing of a transaction, even if it does not concern anticipated or pending litigation, so long as the primary purpose for the communication is for the parties to obtain legal advice or to further a legal interest in common to the parties, rather than for purely business purposes.

This latter approach has been adopted by most federal courts and is consistent with Delaware law, but the U.S. Court of Appeals for the Fifth Circuit appears to ascribe to the first approach. Because different courts treat this issue differently, sellers should be aware of the risks of disclosure and take steps to strengthen their ability to rely on the common interest doctrine if the attorney-client privilege is ever challenged. These protective measures for the seller include: 1. entering into a written confidentiality agreement with the purchaser, 2. entering into a written common interest agreement with the purchaser to document their shared legal interest, and 3. limiting the individuals to whom disclosure is made to the purchaser's in-house legal team or outside counsel and any other individuals only as strictly necessary. Deal counsel who are unfamiliar with the common interest doctrine should consider involving their litigation colleagues in preparing the relevant agreements.

2. Does disclosure of information to an M&A participant's financial advisor waive the attorney-client privilege? Investment bankers and other financial advisors are integral members of the deal team. These advisors may be present when privileged information is being discussed and receive privileged documents. In determining whether disclosure to these advisors waives the attorney-client privilege, courts have typically employed three tests.

First, including a financial advisor in otherwise privileged communications does not waive the privilege if the advisor is the "functional equivalent" of an employee of the client. In other words, courts have concluded that whether someone is an independent contractor rather than an employee should not be outcome determinative on the question of whether the privilege applies. However, some courts have narrowly defined the circumstances in which an advisor is the functional equivalent of an employee (i.e., the advisor can have no other clients); as a result, reliance on this test is not foolproof.

Second, the privilege is not waived if the advisor "facilitates" the rendering of legal advice to the client. Under this test, courts have analogized the advisor's role to that of a translator who helps a client's lawyer understand the client's situation. As with the functional equivalent analysis, some courts are more exacting than others in their application of the facilitator test. The broader interpretation of the test upholds the privilege if the subject communication was made in confidence for the purpose of the client obtaining legal advice from its counsel, while the narrower interpretation upholds the privilege only if the communication was necessary for the effective consultation between the attorney and client.

Under the third test, which affords the greatest flexibility for protecting communications with financial advisors, the court does not require that the financial advisor be essential to interpreting or facilitating the provision of legal advice. Instead, if the advisor was involved in communications between the client and its counsel regarding legal matters, the communication generally remains privileged. This approach has been adopted in Delaware.

To help ensure that the privilege is not waived by disclosures to financial advisors, parties should build a record (e.g., in board minutes) supporting that the financial advisor interpreted information for legal counsel or facilitated the provision of legal advice. In addition, the financial advisor should be excluded from attorney-client privileged communications if the financial advisor's participation in such communications is not required for the advisor to provide input on the deal.

Because of uncertainty regarding courts' treatment of attorney-client privilege issues that arise in the context of information shared with a transaction counterparty or a financial advisor (in fact, it is often difficult to predict which state's privilege laws will govern a dispute), transaction participants should proceed with caution in disclosing attorney-client privileged information and, if they disclose privileged information, they should take the precautionary steps outlined above. Parties can take some comfort that many courts have upheld the privilege and thereby recognized that practical realities in M&A transactions sometimes require disclosure of attorney-client privileged information between counterparties to facilitate the deal and that the important role of financial advisors in deals should not be circumscribed by a failure to extend the privilege to them. IHT

Robert B. Little is a partner at Gibson, Dunn & Crutcher in Dallas. His practice focuses on mergers and acquisitions, joint ventures and other corporate transactions.