New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
SEPTEMBER 9, 2021

WHITE-COLLAR CRIME

White-Collar Investigations and Disclosure During Corporate Transaction Due Diligence

By **Elkan Abramowitz**

And **Jonathan S. Sack**

White-collar defense attorneys are commonly engaged to represent companies in government investigations. While such investigations are pending, corporate clients still pursue the usual range of business transactions, including buying or selling a business or borrowing money from a bank or other lender. If a subject of an investigation seeks to borrow money or sell all or part of its business, the lender or buyer will almost certainly seek disclosure of material legal risks, and white-collar defense counsel for the borrower or seller may be called upon by a corporate client to describe an ongoing investigation and give an assessment of its merits.

Several risks flow from such disclosures by counsel. As an initial matter, counsel may feel pressure to provide an assessment that is rosier or simply more definitive than the law or facts known to counsel at the time of the disclosure support. The dangers associated with disclosure are exacerbated by the risk of discovery—either in subsequent civil litigation, or even during the very criminal investigation about which counsel is disclosing information. The government might go to a counterparty and try to find out what counsel for the subject company did and did not say about the facts and likelihood of liability.

In this article, we discuss whether disclosures made under these circumstances are protected from discovery on the basis of the attorney-client privilege and pursuant to the common interest doctrine. We begin with a discussion of a leading decision in the Second Circuit, *Schaeffler v. United States*, 806 F.3d 34 (2d Cir. 2015), and then turn to an important application of *Schaeffler* by Judge Jed Rakoff in *Carnegie Inst. of Washington v. Pure Grown Diamonds*, 481 F. Supp. 3d 276 (S.D.N.Y. 2020). We conclude by considering the inherent risks from disclosure that remain under applicable case law.

Basic Principles

The law recognizes the attorney-client privilege as essential to facilitating "full and frank communication between attorneys and their clients." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). But the privilege is far from absolute. Because the privilege is premised on the expectation of confidentiality of communications between clients and their attorneys, a client who shares privileged information with a third party ordinary waives the privilege. At first blush, counsel's disclosure of privileged information to a counterparty in a corporate transaction would constitute a waiver of privilege.

To avoid waiver, attorneys frequently rely on the common-interest doctrine—an exception to the waiver rule that maintains the privileged nature of attorney-client communications disclosed to certain third parties. The common interest doctrine applies when a third party is engaged in a common legal enterprise with the privilege holder and the disclosure is made in furtherance of that enterprise. See, e.g., *Schaeffler*, 806 F.3d at 40. White-collar defense attorneys are familiar with the doctrine in their role as defense counsel conferring with other counsel representing witnesses or subjects of a government investigation. The doctrine can also apply in the context of a corporate transaction, but its applicability depends on the precise facts surrounding the disclosure.

'Schaeffler v. United States'

In *Schaeffler*, the Second Circuit decided whether the Schaeffler Group—a German automotive and industrial parts supplier—and its majority owner, Georg Schaeffler (together, the Schaefflers), had waived the attorney-client privilege when they shared legal analyses with a consortium of banks (the Consortium). The Schaefflers' relationship with the Consortium stemmed from the Schaeffler Group's attempt to acquire a minority interest in another company via a tender offer. To finance the offer, the Schaeffler Group had executed a loan agreement with the Consortium.

The Schaefflers' tender offer was ill-timed, to say the least. While the offer was pending, the 2008 financial crisis began, and the stock market collapsed. The target corporation's share price plummeted, causing a much larger than anticipated number of shareholders to accept the tender offer. A combination of the miscalculated tender offer and the financial crisis soon threatened the Schaeffler Group's solvency, jeopardizing its ability to meet its payment obligations to the Consortium.

On the verge of insolvency, the Schaefflers engaged lawyers and accountants to advise them on the tax implications of a potential "complex and novel" debt refinancing and corporate restructuring. At the same time, the Schaefflers and the Consortium signed a confidentiality agreement in which they expressed their intent to share privileged documents regarding the proposed refinancing and restructuring without waiving the privilege. Pursuant to that agreement, the Schaefflers shared with the Consortium various legal documents and memoranda analyzing the possible tax consequences of the refinancing and restructuring and identifying potential IRS challenges to the Schaefflers' tax treatment of the transactions. The Schaefflers and their accounting and legal advisors worked closely with the Consortium in analyzing these tax consequences and, ultimately, in effectuating the refinancing and restructuring.

Soon after the Schaeffler refinancing and restructuring, the IRS initiated an audit and issued a summons seeking, among other things, the legal opinions that the Schaefflers had shared with the Consortium. The Schaefflers moved to quash the relevant portion of the IRS summons, but the district court denied the motion, holding that the Schaefflers had waived the attorney-client privilege. The district court acknowledged the Consortium's "enormous stake in the tax consequences of Schaeffler's refinancing and restructuring decisions." *Schaeffler v. United States*, 22 F. Supp. 3d 319, 331 (S.D.N.Y. 2014). Nevertheless, the district court held that the "parties' shared interest in Schaeffler's tax liability was, in the end, an economic one: namely, a desire that the transactions receive favorable tax treatment from the federal tax authorities so that the Schaeffler Group could service its debt to the Bank Consortium." Id.

Although "this common economic interest depended on the resolution of legal issues regarding tax treatment," the court concluded that it did not constitute a common legal enterprise under the common interest doctrine. Id. at 331-32. "What is lacking is any common legal stake in Schaeffler's putative litigation with the IRS. If the Bank Consortium could have been named as a codefendant in the anticipated dispute with the IRS, the result would undoubtedly be different. But only the Consortium's economic interests were in jeopardy." Id. at 333.

On appeal, the Second Circuit reversed the district court and held that the Schaefflers and Consortium shared a legal as well as economic interest. Observing that "[t]he need to protect the free flow of information from client to attorney logically exists whenever multiple clients share a common interest about a legal matter," the Circuit rejected the district court's narrow view of what constitutes a common legal enterprise. *Schaeffler*, 806 F.3d at 40. In the Second Circuit's view, "[p]arties may share a 'common legal interest' even if they are not parties in ongoing litigation," dismissing the district court's reliance on the fact Consortium was not—and could not have been—named as a co-defendant in a dispute with the IRS. Id.

Turning to the facts of the case, the Circuit concluded that the Consortium's "common interest with [the Schaefflers] was of sufficient legal character to prevent a waiver." Id. at 41. It explained that, while the relationship between the Schaefflers and the Consortium was originally commercial in nature, that relationship "was altered" once "the Schaeffler Group faced a threat of insolvency that would in turn cause a default on the Consortium's eleven-billion Euros loan." Id. Because both parties "could avoid this mutual financial disaster by cooperating in securing a particular tax treatment of a refinancing and restructuring"—treatment which would "likely involve a legal encounter with the IRS"—the Schaefflers and the Con-

sortium had a "strong common interest in the outcome of that legal encounter" and in "seeing [U.S. tax] law applied in a particular way." Id.

Moreover, "[t]he documents in question were all directed to the tax issues, a legal problem albeit with commercial consequences … ." Id. "The fact that eleven-billion Euros of sunken investment and any additional sums advanced in the refinancing were at stake d[id] not render those legal issues 'commercial,'" the Circuit held, and thus the "sharing [of] communications relating to those legal issues" did not constitute "a waiver of the privilege." Id.

Potential Transactions

Schaeffler involved lenders and borrowers who had already entered a loan transaction and faced a crisis that affected closely related legal and economic interests. In *Carnegie Institute of Washington v. Pure Grown Diamonds*, Judge Rakoff addressed a superficially similar but, in fact, distinct issue: whether Huron Capital had waived the attorney-client privilege over two PowerPoint presentations that it shared with M7D Corporation, a company in which it was considering making an equity investment at the time of disclosure.

The *Carnegie* privilege dispute arose in the context of an action brought by M7D and another plaintiff for alleged infringement of their patents. In the course of discovery, defendants sought unredacted versions of the PowerPoint presentations prepared by Huron. The presentations reflected Huron's attorneys' legal advice regarding M7D's intellectual property and trade secrets, which they had reviewed while conducting due diligence in anticipation of Huron's investment. Huron and M7D had signed a non-disclosure agreement covering confidential information before sharing the presentations. But, unlike the borrowers and lenders in *Schaeffler*—who had already executed their loan agreement before sharing the privileged materials—Huron and M7D had not yet entered into an investment agreement when the presentations were shared.

In arguing that disclosure of the PowerPoint presentations to M7D did not waive the privilege, M7D asserted that it had a common legal interest with Huron at the time of the disclosure: "Huron, as a potential investor, shared M7D's interest in ensuring that its intellectual property was strong, valid, and enforceable." *Carnegie*, 481 F. Supp. 3d at 279. The court disagreed, concluding that Huron had waived its privilege when it shared the presentations containing its attorneys' analysis with M7D.

The court viewed Huron's status at the time of sharing the analysis, i.e., as a *potential* investor, as dispositive. While M7D "had a legal interest in the scope, validity, and enforceability of its patents, … Huron Capital only *contemplated* purchasing such an interest." Id. (emphasis added). "Put another way, Huron Capital was interested to know whether M7D had viable intellectual property, but if its attorneys had concluded otherwise, it could either have used that as leverage in negotiations with M7D or could have simply walked away." Id. Accordingly, despite their joint commercial activity—which included working together to seek additional investors and secure loans to fund Huron's investment—Huron and M7D did not share a legal interest that protected the information from discovery by a third party.

Conclusion

Schaeffler and *Carnegie* shed light on the scope of the common interest doctrine under federal law and, more specifically, within the Second Circuit. *Schaeffler* gave the doctrine a broad reach, indicating that a shared business interest will be regarded as a common legal interest so long as the counterparties work together to achieve a goal that has common legal as well as commercial aspects. *Carnegie*, on the other hand, suggests a limiting principle; when disclosure is made before a business relationship is established, a common legal interest is less likely to be found. More generally, application of the common interest doctrine is highly dependent on the precise nature of the counterparties' relationship and interests at the time of the disclosure. As a result, white-collar defense counsel should approach with great caution disclosures to a clients' lenders or business partners. What counsel says under these circumstances might very well become the subject of discovery in subsequent litigation.

Elkan Abramowitz *and* ***Jonathan S. Sack*** *are members of Morvillo Abramowitz Grand Iason & Anello P.C. Mr. Abramowitz is a former chief of the criminal division in the U.S. Attorney's Office for the Southern District of New York. Mr. Sack is a former chief of the criminal division in the U.S. Attorney's Office for the Eastern District of New York.* ***Daniel Gordon****, an associate at the firm, assisted in the preparation of this column.*