



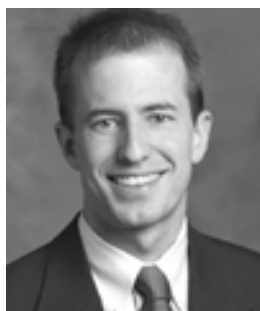
BNA's

HEALTH LAW REPORTER



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Maintaining the Attorney-Client Privilege in Change-in-Control Transactions



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Recent years have seen significant upheaval in the health care industry, with the steep recession casting uncertainty over the health care industry and the economy as a whole, and the advent of health care reform reshaping the regulatory environment for patients, providers and insurers.

Yet despite this economic and regulatory uncertainty, some trends appear to be emerging. First, the passage of federal health care reform legislation appears to be

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spurring consolidation within the health care sector.¹ Second, exposing and eradicating fraud in the health care industry remains a priority for the federal government and whistleblowers, and investigators continue their efforts at uncovering potential fraud in this area. Indeed, in 2009 alone, the U.S. Department of Justice reportedly opened 900 new civil health care fraud investigations, in addition to the more than 1,100 already-pending cases.²

In tandem, trends toward consolidation and investigation raise a number of practical issues for companies involved in health care M&A transactions. Consider the

¹ See L. Walton & C. Chi, "Reform Could Spur Consolidation in Health Sector," *National Law Journal*, July 26, 2010.

² See Attn'y Gen. E. Holder, Remarks at the Health Care Fraud Press Conf. (May 13, 2010) (transcript available at <http://www.justice.gov/ag/speeches/2010/ag-speech-100513.html>).

following hypothetical: Northern Hospital Corporation, a hospital owner and operator, receives an OIG subpoena requesting documents concerning various medical directorships and strongly suspects that a *qui tam* lawsuit has been filed by a disgruntled former employee. Northern's Board of Directors retains outside counsel and an internal investigation is conducted. At the conclusion of the investigation, outside counsel presents the results of its investigation to Northern's Board.

During the course of Northern's investigation, Southern Hospital Corporation contacts Northern about the possibility of acquiring Northern. While conducting due diligence, Southern learns of the OIG subpoena and the possible *qui tam* lawsuit. Southern requests that Northern provide it with a summary of the results of any investigation conducted in response to the OIG subpoena and indicates that it will not consummate the transaction without receiving such information. To complicate matters further, Western Hospital Corporation also approaches Northern about a potential transaction. Northern's Board now faces the difficult decision of whether to disclose the results of its internal investigation of its medical directorships to Southern and/or Western.

Disclosure of privileged information to third parties can have serious consequences. In most circumstances, disclosure of such information to third parties results in waiver of the attorney-client privilege and/or the protection afforded by the attorney work product doctrine. And, if the privilege is deemed to have been waived, a party may be required to disclose the privileged information to the government or other adversary in legal proceedings. Such information often times will include evaluations of potential liability and/or damages, summaries of witness interviews and similar sensitive information.

Given the potential consequences, Northern obviously would be reluctant to disclose such information to third parties. On the other hand, a company hoping to merge with or acquire a company that is the subject of an investigation or party to a *qui tam* lawsuit cannot be confident in its valuation of the target company if it does not have a clear understanding of any potential liability it may be acquiring. To be sure, when the thorny issue of whether and how much information should be shared arises during the course of M&A negotiations, parties often will spend as much time negotiating such disclosure as they do on the substantive deal points of the transaction.

The Common Interest Doctrine

In certain situations, courts have fashioned exceptions to the general rule that disclosure of privileged information to third parties results in a waiver of the privilege. These exceptions developed in the context of criminal proceedings, in which courts permitted defendants to share privileged information among counsel without waiver. The law has developed over time to allow parties to civil proceedings to share privileged information as well, but only when the parties have a sufficiently common interest. In the context of legal proceedings, the "common interest doctrine," as it has become known, is premised on a recognition of the need for an exchange of information among attorneys representing parties that share a common legal interest in litigation.

In the context of a commercial change-in-control transaction, some courts have recognized that the parties may rely on the common interest doctrine to share privileged information without resulting in waiver. The ability to share information in these circumstances, however, is not universal and may turn on the particular jurisdiction in which the issue is being litigated. And, even among those jurisdictions recognizing the common interest doctrine in the context of a commercial transaction, there is likely to be considerable uncertainty as to when the privilege might apply and when parties can safely share privileged information.

When Does the Common Interest Doctrine Apply in a Change-in-Control Transaction?

There is no hard and fast rule regarding application of the common interest doctrine in a change-of-control transaction. A court's *ex post* assessment of whether the attorney-client privilege has been waived between parties to a change-in-control transaction will be fact-intensive and informed by a number of considerations.

First and foremost, parties contemplating an exchange of privileged information must determine whether the exchange of information is for legal rather than merely commercial purposes. Absent an exchange of information in furtherance of a legal purpose, the common interest doctrine typically will not apply. The fact that parties work together to achieve a commercial goal (i.e., consummation of a change-in-control transaction) does not, standing alone, result in an identity of legal interests between the parties. As one court has explained, "[i]t is of no moment that the parties may have been developing a business deal that included as a component the desire to avoid litigation . . . such a desire does not transform their common interest and enterprise into a legal, as opposed to a commercial, matter."³

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For this reason, the disclosure of privileged information in the context of a change-in-control transaction may not be protected if the sole purpose of the disclosure is to persuade the party receiving the information to continue with or complete the transaction, to obtain financing or to assist in a valuation of the company. Moreover, courts have held that the common interest doctrine does not encompass the formulation of a business strategy or negotiation of a transaction that happens to involve concerns regarding litigation as one of its components. Rather, the exchange of privileged information must be in furtherance of developing a joint legal strategy for dealing with legal issues.⁴ If such a le-

³ *Bank of America, N.A. v. Terra Nova Ins. Co.*, 211 F. Supp. 2d 493, 497 (S.D.N.Y. 2002) (citations and quotation marks omitted).

⁴ *Walsh v. Northrop Grumman Corp.*, 165 F.R.D. 16, 18 (E.D.N.Y. 1996).

gal interest exists, courts likely will not require the pendency of actual litigation or require that litigation be on the horizon as a prerequisite to application of the common interest doctrine.⁵

In addition to requiring a “legal” interest, the interest between the parties must be “common.” Courts have applied differing standards regarding how common the interest must be to trigger the protections of the common interest doctrine. At one end of the spectrum, a common interest can be shown so long as the parties’ interests are substantially similar.⁶ A stricter application of the common interest doctrine, however, may require that the parties’ interests be identical.⁷

This distinction may have significance depending on whether the transaction at issue is structured as a merger or equity purchase on the one hand, or an asset purchase, on the other. Given the assumption of liabilities by operation of law in a merger or equity purchase, courts are more likely to find a sufficient commonality of legal interests in that type of structure. When the transaction involves only the acquisition of assets – where pre-closing liabilities are retained by the seller – courts are less likely to recognize a commonality of legal interests.

The mere fact that parties may be on adverse sides of a business deal does not always preclude them from sharing a common interest sufficient to allow for application of the common interest doctrine and the protection of shared privileged information.⁸ The timing of the disclosure of the privileged information and the certainty of the transaction, however, may shed light on whether the parties’ interests are sufficiently common. For a party contemplating disclosure of privileged information to a suitor, the safest course would be to refrain from disclosing the information until the parties are reasonably certain the transaction will close.

Disclosure of information early in the process increases the risk that a court will find that the parties are adversaries negotiating a business transaction rather than parties jointly working to develop a post-closing legal strategy. In some cases, courts have gone so far as to require a signed merger agreement before finding the parties’ interests sufficiently common for the doctrine to apply.⁹ It certainly can be said that such decisions do not reflect the practical realities surrounding due diligence and the exchange of information in change-in-control transactions.

For obvious reasons, the existence of multiple suitors or disclosure of information to multiple potential bidders likely will weigh heavily against a finding that disclosure of privileged information to third parties did not result in waiver.¹⁰ Courts faced with such facts likely

will not find the parties’ interests sufficiently common in such circumstances.

In addition to the foregoing factors, courts considering application of the common interest doctrine often examine a number of practical considerations as well. It is advisable that parties sharing privileged information enter into oral or written confidentiality and/or joint defense agreements and mark privileged documents as “Privileged & Confidential.” While parties contemplating change-in-control transactions often exchange information pursuant to non-disclosure agreements, parties should contemplate an additional confidentiality agreement to address the exchange of privileged information.¹¹ The use of an additional confidentiality agreement executed well into the due diligence process may also support the argument that there was a reasonable certainty that the transaction would close at the time the privileged information is shared.

Moreover, parties should limit the sharing of privileged information to only the information that is absolutely necessary for the purposes of advancing the parties’ common legal interest and should limit the exchange of information to a select group of individuals. It is also advisable to limit the disclosure of such information to attorneys only if possible. Such practical considerations likely will lend further support to an argument in favor of application of the common interest doctrine’s protections from disclosure.

To Disclose or Not To Disclose

In the scenario above, the parties would be well served to research whether and to what extent the common interest doctrine applies in any jurisdictions in which these companies might be litigating the subject matter of the internal investigation, the potential *qui tam* lawsuit and/or the transaction itself. If such research supports application of the common interest doctrine, Northern should wait until sufficient headway exists with respect to the consummation of the transaction with *one* of the two potential suitors before disclosing privileged information with that party. Attorneys for Northern should work with the potential suitor to determine exactly what privileged information is necessary to advance the parties’ common legal interests. By limiting any exchange of privileged information to attorneys for the parties and exchanging such information pursuant to a confidentiality agreement that specifically addresses the exchange of privileged information, the parties can provide further support to the argument that the common interest doctrine should apply.

Regardless of the prophylactic measures taken in connection with the disclosure of privileged information, the protections afforded by the common interest doctrine are by no means a certainty. Given the consequences of a determination of that the attorney-client privileged has been waived, the decision to disclose privileged information to third parties must be carefully considered. Anticipated consolidation within the health care industry and the certainty of the federal government’s continued civil and criminal enforcement efforts and whistleblower *qui tam* lawsuits undoubtedly will bring the common interest doctrine to the forefront in an ever-increasing way.

¹¹ *BASF Aktiengesellschaft v. Reilly Indus. Inc.*, 224 F.R.D. 438, 443 (S.D. Ind. 2004).

⁵ *FSP Stallion 1, LLC v. Luce*, 2010 U.S. Dist. LEXIS 110617, *56 (D. Nev. Sept. 30, 2010).

⁶ *Louisiana Municipal Police Employees Retirement Sys. v. Sealed Air Corp.*, 253 F.R.D. 300, 310-11 (D.N.J. 2008).

⁷ *Shamis v. Ambassador Factors Corp.*, 34 F. Supp. 2d 879, 893 (S.D.N.Y. 1999).

⁸ *Compare Hewlett-Packard v. Bausch*, 115 F.R.D. 308 (N.D. Cal. 1987), with *Nidec Corp. v. Victor Co.*, 249 F.R.D. 575 (N.D. Cal. 2007).

⁹ See generally *Katz v. AT&T Corp.*, 191 F.R.D. 433 (E.D. Pa. 2000); see also *In re JP Morgan Chase & Co. Sec. Litig.*, 2007 U.S. Dist. LEXIS 60095, *13-14 (N.D. Ill. Aug. 13, 2007).

¹⁰ *Nidec Corp.*, 249 F.R.D. at 579.