Advisory

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Applying the "Common Legal Interest" Privilege In the Context of a Financial Transaction

Sophisticated and complex commercial litigation and criminal investigations often involve many participants and their lawyers. In these cases, it is often beneficial for the lawyers to share confidential information pursuant to a joint defense or common interest privilege. Under such an arrangement, the lawyers for clients with common legal interests can disclose information without waiving the attorney-client privilege. But what happens when not all of the participants have an equal interest in the legal outcome, or where one participant only has a financial interest? Does that destroy the privilege? On November 10, 2015, the U.S. Court of Appeals for the Second Circuit answered "no" to that question, holding that a common legal interest may be established where participants in a business relationship had a strong common interest in the outcome of a legal matter, even where one of the participants only had a financial interest in the outcome. *Schaeffler Holding, LLP v. United States*, No. 14-1965, 2015 WL 6874979 (2d Cir. 2015).

BACKGROUND

With an 11 billion euro loan from a consortium of banks (the "Consortium"), the Schaeffler Group made a tender offer for Continental AG. Nearly 90% of Continental AG's shareholders accepted the tender offer – a far larger amount than the Schaeffler Group ever anticipated or prepared for. With financial ruin on the horizon, the Schaeffler Group, at the suggestion of the Consortium, restructured and sought to refinance its acquisition debt. The Schaeffler Group hired an accounting firm, Ernst & Young, and a law firm, Dentons LLP.

Both the Schaeffler Group and the Consortium believed that the restructuring and refinancing would result in serious tax consequences and an eventual IRS audit. With that in mind, the Schaeffler Group asked Ernst and Young to produce a memo assessing the tax implications and possible liability stemming from the transactions. Upon receipt of the memo, the Schaeffler Group shared the memo with the Consortium so that it was aware of the risks, as the Consortium was relying on the restructuring and refinancing to avoid an enormous loss on its initial loan.

An IRS audit did indeed follow. The IRS requested disclosure of the Ernst & Young memo. The Schaeffler Group objected, arguing that the memo was protected by the attorney-client privilege (pursuant to the "tax practitioner" extension of privilege) and the work-product doctrine.1

ATTORNEY-CLIENT AND COMMON INTEREST PRIVILEGE

Confidential attorney-client communications are protected if they are made for the purpose of obtaining or providing legal advice. On the other hand, communications that are made to evaluate commercial issues, or that are made more for commercial purposes than legal ones, are

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usually not protected. *Schaeffler Holding, LLP*, 2015 WL 6874979, at *4; *see also In re County of Erie*, 473 F.3d 413, 419 (2d Cir. 2007) (holding that courts consider whether the predominant purpose of a communication is to render or solicit legal advice in determining whether the attorney-client privilege applies).

This distinction between legal and business advice impacts the common interest privilege, and was the issue at the heart of the *Schaeffler* decision. While the attorney-client privilege is normally waived when communications are voluntarily disclosed to others outside the privilege relationship, the privilege is not waived when the communication is made to someone with a common **legal** interest. *Id.* at *4. The common legal interest doctrine "serves to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel." See *United States v. Schwimmer,* 892 F.2d 237, 243 (2d Cir. 1989). The doctrine protects communications "made in the course of an ongoing common enterprise and intended to further the enterprise." *Schaeffler Holdings, LLP*, 2015 WL 6874979, at *5. (quoting *Schwimmer*, 892 F.2d, at 243). The dispositive issue in *Schaeffler* was "whether the Consortium's common interest with [the Schaeffler Group] was of a sufficient legal character to prevent a waiver by the sharing of those communications." *Id.* at *5.

The District Court held that the Schaeffler Group waived the attorney-client privilege when it knowingly shared the Ernst & Young memo with the Consortium because only the Consortium's commercial interests were at stake, not its legal interests. In other words, the Consortium could not have a "common legal interest" with the Schaeffler Group.

The Second Circuit disagreed. Although the refinancing and restructuring had both a commercial and tax law component, the Court found that the Consortium and the Schaeffler Group had a common interest in securing a particular legal outcome – the advantageous tax treatment for the Schaeffler Group's refinancing and restructuring. Without that beneficial tax treatment, the Schaeffler Group would have defaulted on the Consortium's loan, which would have had severe negative financial consequences for the Consortium. "[I]t was the interest in avoiding the losses that established a common legal interest." *Id.* at *7.

Therefore, the Court held that sharing the Ernst & Young memo relating to the legal issues at stake in the refinancing and restructuring did not constitute a waiver of the attorney-client privilege. Summarizing its holding, the Court said, "[a] financial interest of a party, no matter how large, does not preclude a court from finding a legal interest shared with another party where the legal aspects materially affect the financial interests." *Id.* at *7.

SUGGESTIONS FOR PRESERVING THE COMMON INTEREST PRIVILEGE

Although whether the common interest privilege applies in any given situation is a fact-intensive inquiry, there are several factors that make it more likely that a court will find that a common legal interest exists.

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As a threshold matter, the party asserting the privilege will need to prove that it shared confidential attorney-client privileged communications with a non-party for a legal purpose as opposed to a purely commercial one. Parties should therefore carefully consider the purpose of sharing information before it is shared, to make sure there is a legitimate legal purpose.

In addition, where a non-party's interest is commercial, the privilege holder will have to show that the non-party's commercial interest will be affected by a legal outcome, and will also likely have to show the commercial interest is significant. For example, demonstrating involvement in the legal strategy by the non-party with the commercial interest can show they had an interest in the legal matter. Facts that the Court considered important in *Schaeffler* provide guidance: (1) the Consortium's counsel worked with the Schaeffler Group and advised it to restructure and refinance, and needed access to confidential information, including tax advice that the Schaeffler Group received from Ernst & Young; (2) the parties shared information pursuant to a confidentiality agreement, which the Court cited as evidence that the parties intended to keep their communications confidential. *Id.* at *6; and (3) the Schaeffler Group agreed with the Consortium that it could not act unilaterally during the IRS audit in certain circumstances. *Id.*

Given the relevance of these facts in *Schaeffler*, businesses that seek to establish a common legal interest in an outcome or a strong financial interest in a legal outcome should consider documenting their interests contemporaneously. This can be done through a formal joint defense agreement or confidentiality agreement that recognizes the common interest. In the absence of a formal agreement, parties should consider noting in their communications that they are being shared pursuant to a common interest. While simply stating that a common legal interest exists does not establish the interest, it may constitute evidence of the parties' intent that a court will later find persuasive. Even without documentation, it is important that business partners act in a manner that is consistent with a common legal interest, such as by keeping information confidential other than as between them.

[1] Title 26 U.S.C. § 7525 (a) (1) provides that "the common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney." This "tax practitioner privilege" is, therefore, essentially coterminous with the attorney-client privilege both in scope and waiver. Schaeffler Holding, LLP, 2015 WL 6874979, at n. 3 (citing United States v. BDO

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