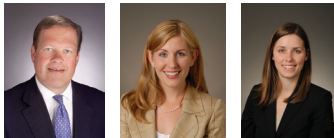


Corporate and M&A Law

Negotiated Transactions

Transaction Advisors

Financial Advisors and the Attorney-Client Privilege



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Investment bankers and other business advisors frequently are key participants in corporate transactions. This makes it important for counsel to understand the application of the attorney-client privilege with respect to such advisors and to carefully consider the circumstances under which such advisors are considered third parties whose review of or participation in confidential communications may waive the privilege.

This is not a simple task because courts analyze the effect of the disclosure of privileged information to third-party consultants

under three separate analytical frameworks. Under the first, the involvement of 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. Under the second, the attorney-client privilege is not waived if the financial advisor is essential to “facilitating” the rendering of legal advice to the client. Under the third, courts focus on the parties’ expectations concerning confidentiality and the subject matter of the communication—whether it involves legal matters being communicated between the client and its attorneys.¹

Further complicating the matter, courts sometimes use more than one framework in a single case, and different courts may apply the same basic frameworks differently. This article examines these three approaches and how courts have applied them. It evaluates how these approaches serve the purposes of the attorney-client privilege and addresses possible issues with their application.

The Financial Advisor as the Functional Equivalent of the Client’s Employee

Some courts have held that financial advisors and other consultants do not waive the attorney-client privilege where they are the “functional equivalent” of the client’s employees. This approach initially developed as an extension of *Upjohn Co. v. United States*, in which the U.S. Supreme Court rejected the “control group” test and determined that applying the attorney-client privilege only to communications with senior management failed to encourage the type of open communication that the privilege was meant to promote.² Just as limiting the privilege to a narrow group of a corporate client’s management hinders effective attorney-client communication, restricting the privilege only to the corporation’s employees “will lead to attorneys not

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being able to confer confidentially with nonemployees who, due to their relationship to the client, possess the very sort of information that the privilege envisions flowing most freely.”³

An often-cited Eighth Circuit opinion in *In re Bieter Co.* illustrates this approach. There, Bieter retained an independent consultant who was extensively involved in Bieter’s real estate development business. The consultant was primarily responsible for the real estate negotiations that were the subject matter of the underlying litigation and was often the company’s sole representative in negotiations with third parties and in communications with Bieter’s attorneys.⁴ The court determined that the consultant’s participation in privileged communications with Bieter’s counsel did not waive the attorney-client privilege because (1) the consultant was the functional equivalent of the client’s employee; (2) the communications at issue were within the scope of the consultant’s duties; (3) the communications were made at the behest of the consultant’s client; and (4) the communications were made for the purpose of seeking legal advice for the client.⁵

Under these circumstances, the court found that there was “no principled basis to distinguish [the consultant’s] role from that of an employee” and that “his involvement in the subject of the litigation [made] him precisely the sort of person with whom a lawyer would wish to confer confidentially in order to understand [the client’s] reasons for seeking representation.”⁶ Other courts have similarly found that the participation in or disclosure of privileged communications to advisors or consultants who are the functional equivalents of employees does not waive privilege.⁷

The functional equivalent standard is useful to identify a class of consultants whose presence does not waive privileges. It is more problematic, however, when the standard is used to find that a waiver has occurred. For example, the court in *Export-Import Bank of the United States v. Asia Pulp & Paper Co., Ltd.*⁸ held that the attorney-client privilege did not extend to communications shared with a corporation’s financial advisor even though the advisor spent 80 percent of his time working on the client’s business. The fact that the consultant had an active consulting practice involving other clients and that he had an office in another city were held to “contradict the picture of [the consultant] as so fully integrated into [the Company’s] hierarchy as to be a *de facto* employee.”⁹

The factors the *Export-Import* court cited to find a waiver of the privilege had little to do with whether the financial advisor at issue had the kind of important information to share with its client’s counsel that the *Upjohn* Court found to be significant. Instead of embracing the principles of *Upjohn*,¹⁰ the *Export-Import* court emphasized its concerns about enlarging the scope of the privilege.¹¹ With this focus, the *Export-Import* court’s narrow application of the functional equivalent test undermines the policies of *Upjohn*. Basing the privilege determination on factors unrelated to the advisor’s specific role in the transaction or access to knowledge will not encourage the free flow of corporate information that the *Upjohn* Court sought to promote. As a result, the *Export-Import* approach may diminish the free flow of information between corporate counsel and the client by resting the privilege determination on potentially arbitrary indicia of *de facto* employment.

In addition, this standard undermines the client’s certainty over whether communications with the consultant are privileged. Corporate counsel, her client, and her client’s advisors may not know the precise contours of the advisor’s engagement at the outset of that engagement or may not know whether a particular court would find that the specific circumstances of the engagement render the advisor the functional equivalent of a corporate employee. Without knowing with certainty whether communications with the advisor are privileged, corporate counsel may be reluctant to fully integrate her client’s advisors into the transactional team.¹²

These issues and the outcome in *Export-Import* illustrate the shortcomings of the functional equivalent test. It allows courts to narrowly define the circumstances in which an advisor is the functional equivalent of a corporate employee in order to prevent too broad an application of the privilege, an approach that results in arbitrary privilege determinations and undermines the free flow of information principle of *Upjohn*.

The Financial Advisor as Interpreter or Facilitator

Other courts have taken a different approach, analyzing whether the advisor “translates” financial information for corporate counsel. This analysis developed from the Second Circuit’s opinion in *United States v. Kovel*. There, the court found that applying the privilege to communications between the client and a tax accountant for the purpose of helping the client’s lawyer understand the client’s complicated tax situation was analogous to applying the privilege to communications between a foreign language interpreter and a client for the purpose of helping the client’s lawyer understand the client’s story.¹³

As with the functional equivalent analysis, different courts apply the interpreter analysis with varying levels of strictness. Some courts adopting this approach require that the financial advisor’s role be limited narrowly to interpreting financial principles in order for the advisor not to waive the privilege. For example, in *United States v. Ackert*, the court held that an investment banker’s communications with or in the presence of corporate counsel were not privileged because “[the investment banker’s] role was not as a translator or interpreter of client communications.”¹⁴ Strict application of the interpreter approach may not protect communications with a financial advisor who serves a more substantial decision-making and information gathering function in corporate transactions.¹⁵

Other courts take a broader view and consider the financial advisor to be within the scope of the privilege where the advisor “facilitates” the attorney’s provision of legal advice.¹⁶ For example, in a Southern District of New York case, *Urban Box Office Network, Inc. v. Interfase Managers, L.P.*,¹⁷ the court found that “[w]hat is relevant is whether the communications with the attorneys were made in confidence for the purpose of the client obtaining legal advice from its counsel, *i.e.*, ‘to help [the attorney] reach the understanding he needed to furnish legal advice.’”¹⁸ The *Urban Box Office* court applied this standard to find several communications privileged, including: (1) an email

seeking information from the plaintiff's advisors in order to gather information for counsel's use in the litigation about the failed transaction at issue in the case; (2) a communication between counsel and the plaintiff's advisor in which counsel provided advice on a disclosure statement, which the court found to "provide the benefit of legal insight and advice;" and (3) a draft of a disclosure schedule sent from counsel to the plaintiff's advisor, the "completeness and accuracy [of which] clearly had legal implications with which the attorneys would be concerned."¹⁹ The advisor's draft of a financial table and the attorneys' comments on them, on the other hand, were held to be a purely business communication and not privileged.²⁰

In a similar fashion, in a Northern District of Illinois case, *Stafford Trading, Inc. v. Lovely*,²¹ the court applied the facilitator analysis to determine whether communications shared with the plaintiff's investment banker were privileged. After thoroughly discussing the functional equivalent test, the *Stafford Trading* court ultimately found that rule to be "too restrictive."²² Endorsing the approach from *Urban Box Office*, the court emphasized that counsel's communications with the plaintiff's financial advisors were confidential and noted that "in today's market place, attorneys need to be able to have confidential communications with investment bankers to render adequate legal advice."²³

The court acknowledged that under this approach, it could not determine wholesale whether the communications at issue were privileged.²⁴ Rather, analyzing the privilege document by document, the court determined several communications with the financial advisor to be privileged, including, among others: (1) an email from the financial advisor forwarding a draft agreement to counsel and key employees of the plaintiff, which "was given to [counsel] for the purpose of obtaining legal advice with regard to a number of the terms"; (2) communications from counsel to the plaintiff and its financial advisor providing legal advice regarding the drafting of an agreement and the structure of the transaction at issue; (3) an email from the financial advisor to the plaintiff and its counsel summarizing certain issues in the transaction, which although "walk[ing] the fine line between business and legal advice," was "primarily sent for the purpose of seeking legal advice."²⁵

By rejecting the functional equivalent test as overly restrictive, and adopting an analysis that focused more on the nature of the communications at issue than the precise relationship between the financial advisor and her client, the *Urban Box Office* and *Stafford Trading* courts adopted an analysis that is more closely tied to the fundamental purposes of the attorney-client privilege. The primary defect of the "facilitator" approach is that the extension of the privilege turns on facts that have little to do with the character of the privileged communication. As a result, some courts have relied on the "facilitator" analogy to limit the privilege to circumstances where the financial advisor's presence is "necessary for the effective consultation between [attorney and client]."²⁶ As with the functional equivalent standard, this narrow formulation of the facilitator standard may result in privilege waivers in the case of legal communications of the most sensitive kind that all parties intend should remain confidential.

The Financial Advisor and Communications Involving Legal Matters

The more recent Delaware Chancery Court opinion in *3Com Corp. v. Diamond II Holdings, Inc.*²⁷ discusses a third approach, which affords the greatest flexibility for protecting confidential communications with financial advisors and other business consultants. Under this approach, the court does not require that the financial advisor is essential to interpret or facilitate the provision of legal advice to the client. The court instead determines whether the advisor was involved in communications between the client and its counsel regarding legal matters. If so, the communication generally remains privileged, regardless of its disclosure to the financial advisor.²⁸

The *3Com* decision compared this approach to the somewhat stricter interpreter/facilitator approach. The court began by noting that either Massachusetts or Delaware law might apply and discussing how each differed with respect to determining whether the communications in that case were privileged.²⁹ As the court discussed, under Massachusetts law, attorney-client communications made in the presence of a third party "are privileged only when the third party's presence is necessary for the effective consultation between client and attorney."³⁰ The fact that the third party improved the attorney-client communication, even substantially, is not enough to qualify for protection under Massachusetts law.³¹ In contrast, Delaware law supports a broader approach in which the court determines "whether in the circumstances the person making the disclosure in fact regarded that disclosure as confidential and, if there was an expectation of confidentiality, whether the law will sanction that expectation."³²

In light of these different approaches, the court conducted a choice-of-law analysis and determined that it would apply Delaware law with respect to privilege.³³ Although many of the allegedly privileged communications occurred in or originated at *3Com*'s offices in Massachusetts, the court held that "Delaware has a considerable interest in ensuring that corporate entities seeking a business combination under its laws may expect consistent and predictable treatment when appearing before its courts."³⁴ The court thus held that Delaware law applies in evaluating attorney-client privilege with respect to "communications that take place among a client, its attorney and its investment bankers when those parties are discussing the merits of a complex transaction, such as a merger, for which they have selected Delaware law and Delaware as a forum for resolution of any disputes that might arise."³⁵

Applying Delaware law, the court determined that "insofar as Goldman Sachs was involved in communications between *3Com* and its attorneys involving legal matters, those communications are privileged."³⁶ The court went on to note that "Goldman Sachs' precise role in a specific communication is not critical as long as it involved legal issues regarding the transaction and participation by *3Com*'s attorneys."³⁷ In fact, the court held that even internal communications between Goldman Sachs bankers may be

privileged to the extent they “were discussing information of a legal nature that they received from a communication that did, in fact, involve 3Com’s legal representatives.”³⁸

This standard best promotes the interests that the *Upjohn* Court identified. For one, its clear focus on the nature of the communication at issue promotes open attorney-client communication without creating unnecessary hurdles to application of the privilege. In contrast, by focusing too much on the role of the advisor, a strict functional equivalent test or interpreter/facilitator test—like the restrictive control group approach the *Upjohn* Court rejected—may undermine the free flow of attorney-client communication that the attorney-client privilege was meant to promote. Further, the *3Com* analysis better promotes predictability, which the *Upjohn* Court noted was an important part of encouraging open attorney-client communication.

Conclusion

Given the involvement of financial advisors in corporate transactions, it is important for counsel to understand the various approaches that courts have used to determine whether the presence of a financial advisor waives the attorney-client privilege. Attorneys and their clients need a certain confidence that they are able to freely communicate with their financial advisors while negotiating, analyzing, and structuring complex corporate transactions. This result is most certain when Delaware law applies to the transaction, and a Delaware forum selection clause applies. The same result applies when courts rely upon the more flexible version of the facilitator standard of *Urban Box Office* and *Stafford Trading*. In other jurisdictions, the result may be less certain and, as a result, communications with third-party advisors more circumspect.

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¹ The communication at issue must concern legal advice, as opposed to business or other advice, to qualify for the attorney-client privilege in the first place. See, e.g., *Amway Corp. v. Procter & Gamble Co.*, No. 1:98-cv-726, at *5 (W.D. Mich. Apr. 3, 2001) (“Thus, for the privilege to be applicable, the proponent must demonstrate that the lawyer has acted in a legal capacity rather than in any of the other functions that legally trained individuals perform in our society.”).

² 449 U.S. 383, 390 (1981) (“[The control group test] overlooks the fact that the privilege exists to protect not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice.”).

³ *In re Bieter Co.*, 16 F.3d 929, 937-38 (8th Cir. 1994).

⁴ *Id.* at 934 (“[The consultant’s] involvement with counsel was rather extensive. He often attended meetings with counsel, either alone or with [his client] [The consultant] received many communications from attorneys, both those sent directly to him and those on which he was copied.”) (citations omitted).

⁵ *Id.* at 939-40.

⁶ *Id.* at 938.

⁷ See *FTC v. GlaxoSmithKline*, 294 F.3d 141, 148 (D.C. Cir. 2002) (determining that privileged communications shared with public relations and government affairs consultants were protected by the attorney-client privilege where “there is no reason to distinguish between a person on the corporation’s payroll and a consultant hired by the corporation if each acts for the corporation and possesses the information needed by attorneys in rendering legal advice”); *In re Copper Mkt. Antitrust Litig.*, 200 F.R.D. 213, 219 (S.D.N.Y. 2001) (Where a corporation had retained a public relations firm that was “incorporated into [the corporation’s] staff to perform a corporate function that was necessary in the context of the government investigation, actual and anticipated private litigation, and heavy press scrutiny,” communications with the firm are protected by the attorney-client privilege.); *McCaugherty v. Siffermann*, 132 F.R.D. 234, 239 (N.D. Cal. 1990) (“[W]ith respect to communications relating to the sale of [the company], we can find no principled basis for distinguishing [the company’s financial advisors] from the kinds of employees to whom the Supreme Court extended the protection of the privilege in *Upjohn*.”).

⁸ 232 F.R.D. 103 (S.D.N.Y. 2005).

⁹ *Id.* at 113-14.

¹⁰ The court does not cite *Upjohn* once in its discussion of the attorney-client privilege.

¹¹ See *id.* at 114 (“If the functional equivalent doctrine were extended to every situation where a financial consultant worked exhaustively to guide a company through a restructuring deal, the exception would swallow the basic rule, set forth in *United States v. Arthur Young & Co.*, 465 U.S. 805, 817, 104 S. Ct. 1495, 79 L. Ed. 2d 826 (1984), that there is no privilege protecting communications between clients and their accountants.”). The court’s concern with *Arthur Young & Co.* is misplaced. For one, the court in that case was deciding whether to recognize an accountant-client privilege, not whether disclosure of an otherwise attorney-client privileged document to an accountant would waive that privilege. See *Arthur Young & Co.*, 465 U.S. at 817. Furthermore, the court recognized that an accountant has a different relationship with its clients than other advisors do. See *id.* at 817-18 (“By certifying the public reports that collectively depict a corporation’s financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to the investing public.”).

¹² See *Upjohn*, 449 U.S. at 393 (“An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all.”).

¹³ See *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961) (“Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases. Hence the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege, any more than would that of the linguist in the second or third variations of the foreign language theme discussed above; the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit.”). See also *Ferko v. Nat’l Ass’n for Stock Car Auto Racing, Inc.*, 218 F.R.D. 125, 135, 140 (E.D. Tex. 2003) (sustaining the defendant’s claim of privilege where the defendant’s counsel “retained Ernst & Young’s accountants to serve as listening posts, and interpret documents related to SFAS Nos. 141 and 142” and where the “accountants helped translate financial information for [the defendant’s counsel] into a form intelligible to a lawyer at a lawyer’s behest”) (internal quotations omitted).

¹⁴ *United States v. Ackert*, 169 F.3d 136, 140 (2d Cir. 1999).

¹⁵ See *Akert*, 169 F.3d at 138-39 (finding that the attorney-client privilege did not extend to communications between tax counsel and its client’s investment banker where counsel had sought information about the details of the transaction and its tax consequences from the investment banker so as to advise its client); *Export-Import Bank of the U.S.*, 232 F.R.D. at 113 (finding no privilege under the interpreter analysis where the financial advisor “was by the company’s own reckoning a major participant in [the client’s] financial affairs, not a mere interpreter”); *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065, 1071 (N.D. Cal. 2002) (relying on *Kovel* and noting that “*Kovel* did not intend to extend the privilege beyond the situation in which an accountant was interpreting the client’s otherwise privileged communications or data in order to enable the attorney

to understand those communications or that client data.”); *AVX Corp. v. Horry Land Co., Inc.*, C.A. No. 4:07-cv-3299-TLW-TER, 2010 BL 279892 at *16 (D.S.C. Nov. 24, 2010) (privilege waiver found where environmental consultants “were not simply putting into usable form information obtained from client; rather they were independently gathering their own data, conducting testing . . . and rendering opinions”).

¹⁶ See *Byrnes v. Empire Blue Cross Blue Shield*, No. 98 Civ. 8520 (BSJ) (MHD), at *1 (S.D.N.Y. Nov. 4, 1999) (“[The attorney-client privilege] also encompasses contacts between the attorney and a client’s agent or representative and between the client and the attorney’s agents, provided that the communications are intended to facilitate the provision of legal services by the attorney to the client.”); *Aull v. Cavalcade Pension Plan*, 185 F.R.D. 618, 629 (D. Colo. 1998) (finding documents shared with an accountant to be privileged where “the documents were exchanged in confidence and in order to facilitate [counsel’s] ability to give legal advice.”).

¹⁷ 01 Civ. 8854 (S.D.N.Y. Apr. 17, 2006).

¹⁸ *Id.* at *4 (quoting *United States v. Adlman*, 68 F.3d 1495, 1500 (2d Cir. 1995)).

¹⁹ *Id.* at *7. The court also found communications among the plaintiff’s financial advisors, board members, and attorneys regarding a draft term sheet to be privileged where “it is clear that the advice and suggestions of counsel are being sought” and an email from the plaintiff’s CEO to its counsel and financial advisors about working with litigation counsel, which “communicates the attorney’s views about legal strategy.” *Id.* at **9-10.

²⁰ *Id.* at *6.

²¹ No. 05-C-4868 (N.D. Ill. Feb. 22, 2007).

²² See *id.* at *6.

²³ *Id.*

²⁴ See *id.*

²⁵ *Id.* at **8-9.

²⁶ *Comm’r of Revenue v. Comcast Corp.*, 901 N.E.2d 1185, 1198 (Mass. 2009).

²⁷ C.A. No. 3933-VCN (Del. Ch. May 31, 2010).

²⁸ It can be argued that this was also the standard actually applied by the court in *Stafford Trading*. Although the *Stafford Trading* court rejected the fundamental equivalent standard and purported to rely on the facilitator standard for its rule of decision, No. 05-C-4868 at *14, the court ultimately states the standard it applied as “limiting the privilege to those instances where . . . [the financial advisor] confidentially communicated with [the client’s attorneys] for the purpose of obtaining or providing legal advice.” *Id.* at *16.

²⁹ See C.A. No. 3933-VCN, at *5.

³⁰ *Id.* at *10 (internal quotation marks and citation omitted).

³¹ See *id.*

³² *Id.*, quoting *Jedwab v. MGM Grand Hotels, Inc.*, No. 8077, at *2 (Del. Ch. Mar. 20, 1986).

³³ *Id.* at *6.

³⁴ *Id.* at *5.

³⁵ *Id.* at *1.

³⁶ *Id.* at *6. The 3Com court’s holding is consistent with Delaware authority reaching back 25 years. See *Jedwab*, at *2 (“where a client seeks legal advice as to the proper structuring of a corporate transaction and it is also prudent to seek professional guidance from an investment banker, it would hardly waive the attorney-client privilege for a client to disclose facts at a meeting concerning such transaction at which both his lawyer and his investment banker were present.”); *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, C.A. No. 3841-VCL, at *2 (Del. Ch. Aug. 12, 2008) (attorney-client privilege not waived by communications between client and investment banker concerning legal strategies for making covenants in merger agreement more favorable to client); *Cede & Co. v. Joule, Inc.*, C.A. No. 696-N, at *2 (Del. Ch. Feb. 7, 2005) (“the attorney-client privilege is not waived by the presence of the investment banker”).

³⁷ *Id.*

³⁸ *Id.* at *6 n. 33.