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Client Alert

Federal Court Limits Attorney-Client Privilege for Investment Funds and Their Portfolio Companies

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In a disquieting decision for the managed fund industry, a federal court in the Southern District of New York ruled earlier this year that the attorney-client privilege may not extend to communications between a portfolio company's counsel, on one hand, and board members appointed by an investment fund shareholder, on the other. Given the commonplace practice of fund managers appointing their own employees and partners to the boards of the companies in which they invest, the decision is a warning to act with caution when a portfolio company's lawyers communicate with fund representatives. As discussed below, there are several precautionary steps that can be taken to try to protect the privilege.

In *Argos Holdings Inc. v. Wilmington Trust N.A.*, 2019 WL 1397150 (S.D.N.Y. Mar. 28, 2019), Kirkland & Ellis LLP and Simpson Thacher & Bartlett LLP served as counsel to Argos GP – a portfolio company of the private equity firm BC Partners, Inc., and the ultimate owner of PetSmart Inc. – in connection with PetSmart's 2017 acquisition of Chewy Inc. The firms did not also serve as counsel to BC Partners. In a subsequent dispute by Argos against Wilmington Trust concerning the acquisition, Wilmington Trust sought the production of written communications involving Kirkland and Simpson and three members of BC Partners who served on Argos's board of directors. Argos argued that the communications were protected by the attorney-client privilege; Wilmington Trust countered that the documents, even if they reflected legal advice, lost their privileged status by virtue of being shared with BC Partners representatives.

Judge Denise Cote held that a company's attorney-client privilege does not automatically extend to its shareholder, such that disclosing company counsel's advice to the shareholder can break the privilege. The court held that the privilege determination would therefore turn on whether the communications at issue were sent to the individuals in their capacities as Argos board members, or in their capacities as representatives of BC Partners, the shareholder. The court stated that "[t]here is no established litmus test to assess the capacity in which communications were received where a recipient plays multiple roles in a transaction, with only one of those roles allowing for the receipt of privileged communications." Judge Cote instead examined the particular facts and circumstances surrounding each of the communications to determine which "hat" the individuals were wearing at the time of receipt.

As to many of the documents in question, the court found that the recipients were acting as BC Partners representatives and not company directors, thus destroying the privilege, including because: the communications were not sent to all board members; the communications were sent to the individuals at their BC Partners email addresses; and there were no steps taken to prevent the sharing of the communications with other BC Partners personnel, such as the use of a confidentiality "protocol" or "training designed to protect the privilege." By contrast, the court held that the privilege applied to communications that were sent to the entire Argos board, and to documents on which the recipients were

specifically identified “by their relationship to PetSmart or Argos GP,” and not by any association with BC Partners. The court acknowledged that there may be situations where a company’s privileged documents can be safely disclosed to a shareholder, such as when the shareholder and the company are joint clients of the same law firm, or when they have a “common interest” (for example, when they share documents to advance a joint defense in litigation). Those theories were not advanced in *Argos*, leading Judge Cote to reiterate that “the argument that an entity’s privilege extends to its shareholders and investors” is insufficient.

The decision relied in part on earlier cases recognizing that the privilege can be lost when individuals receiving legal communications were not acting on behalf of the client but instead were operating in another capacity. But those earlier cases did not involve the managed fund context, and did not lay out, as in *Argos*, methods for determining whether a recipient was acting for the company or for a different entity. In the absence of higher authority or more on-point precedent, it is unclear to what extent the *Argos* court’s reasoning will be adopted by other judges. If followed, however, the *Argos* decision, and the strict approach it takes to the attorney-client privilege, may upset common practice and expectations within the managed fund world.

In light of *Argos*, fund managers and their portfolio companies should consider steps to safeguard the attorney-client privilege, including: having fund-appointed board members use company domain email addresses (or a company-provided communications portal) to conduct board business, or employ some other method to distinguish between fund and board responsibilities; entering into common-interest or joint-defense agreements between the fund and the portfolio company; and implementing a protocol or training for fund personnel on how to maintain the confidentiality of portfolio company documents. Lawyers counseling portfolio companies should likewise be mindful of taking steps to distinguish between communications with directors in their board roles versus their fund employee roles, as well as providing context-specific direction on how to safeguard the privilege.

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