

## **I. Important Rules Regarding Ethical Considerations in Bank Mergers**

### **a. General Counsel Concerns: Who Is My Client?**

#### **i. Interests of the Institution versus the Interests of the Institution's Officers, Agents, Directors and Shareholders**

It is axiomatic that a corporation or a financial institution is a distinct, discrete legal entity that exists separate and apart from its officers, agents, directors, and shareholders. A lawyer retained to represent a corporation owes his allegiance solely to that legal entity, and not to the corporation's officers, directors, and shareholders.<sup>1</sup>

These basic rules, however, become blurred when the lawyer representing a financial institution is confronted by a desired merger and acquisition.<sup>2</sup> In this situation, the lawyer who represents the institution must ensure that the decision for a merger and acquisition is approached with the best interest of the financial institution and not that of the institution's officers, directors or shareholders.

In the world of takeovers, mergers, acquisitions, and break-ups, the assumption that the attorney retained by the institution owes its undivided allegiance to the institution itself seem less than solid.<sup>3</sup> In the case of a merger and acquisition of an institution, the lawyer presides over interests clearly adverse to the corporation. At this point, the lawyer's allegiance to the institution is challenged whereby the officers, directors or shareholders perceive that such an action is in their best interest.<sup>4</sup> Clearly, in this situation, the lawyer representing the institution

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<sup>1</sup> MODEL RULES OF PROF'L CONDUCT R. 1.13 (1983); New York Disciplinary Rule 5-109; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 85 (perm. vol. 2000).

<sup>2</sup> See Ralph Jones, *Who is the Client? The Corporate Lawyer's Dilemma*, 39 *Hastings L.J.* 617, 617 (1988).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

may ultimately end up representing the best interests of the shareholders and not those of the institution.

One particular scenario where such conflict exists is whereby the employment of the financial institution's officers, agents and directors is jeopardized by the potential merger and acquisition.<sup>5</sup> The institution's officers, agents and directors will try to avoid the risk of losing their position with the institution by preventing the acquisition. The lawyer representing the institution must decide whether he can ethically advise the board of directors on which the institution's officers and directors sit, and also continue to represent the institution.<sup>6</sup> It is clear that the lawyer's advice relating to the board's fiduciary obligations does not conflict with the lawyer's representation of the institution.<sup>7</sup> However, it is equally clear that the economic interests of the management of the institution and the board may conflict with the interests of the institution.<sup>8</sup>

In order to best represent the interests of the institution and not participate in any wrong doing on behalf of him or herself, the lawyer may suggest to the shareholder directors that he cannot advise them with respect to their rights as shareholders and that they should seek independent counsel to obtain that advice.<sup>9</sup> In addition, the lawyer should instruct both the officers and directors of the institution that they must "put aside their individual economic

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<sup>5</sup> *See Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Ralph Jones, *Who is the Client? The Corporate Lawyer's Dilemma*, 39 *Hastings L.J.* 617, 617 (1988).

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

concerns, disregard the possibility that they may lose a substantial portion of their livelihood, and act solely in accordance with the heavy fiduciary responsibilities imposed upon them by law."<sup>10</sup>

However, it is evident that "illusion has transcended the realities of the situation."<sup>11</sup> In a perfectly ideal world the institution's lawyer would be able to continue to represent the corporation through its merger or acquisition while not being swayed by those decisions or emotions of the institution's officers, agents, directors and shareholders.<sup>12</sup> Reality deems that the perfect situation cannot exist.

#### **ii. The Acquiring Bank: Inquiries While Performing Due Diligence**

Due diligence is one of the key formalities in the merger and acquisition process. It is the practice of examining the financials of the target institution to ensure that there are no surprises in store for the acquirer. While performing due diligence, the acquiring bank questions the general counsel of the target institution as to the institution's overall effectiveness, strengths and weaknesses, customers, markets, technologies, and legal framework. During the due diligence process there is a potential for the acquiring bank to inquire into classified information that is required, under the rules of professional ethics, to remain confidential.

The issue then becomes whether general counsel is able to separate his or her function as counsel and advisor to his or her client, the target bank, while at the same time fulfilling his or her obligation to answer any questions proposed by the acquiring bank in preparation for an acquisition with his or her client. At first glance it may seem as if the rules of professional

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<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> See generally Ralph Jones, *Who is the Client? The Corporate Lawyer's Dilemma*, 39 *Hastings L.J.* 617, 617 (1988).

conduct are against this sort of conflict of interest, however, with a closer look, the rules suggest a degree of flexibility.

### 1. Chinese Walls: *Bolkiah v. KPMG*<sup>13</sup>

To avoid a situation where the general counsel of a target firm may reveal confidential information of his or her client that may create adverse effects, the general counsel should create "Chinese walls" surrounding his or her client's confidential information in order to ensure that the rules of professional ethics governing the attorney-client relationship are not violated. Indeed, with "Chinese walls" surrounding the confidential information held by the general counsel, general counsel could then refer the acquiring bank to direct its due diligence process towards another sector of the target bank or firm. At this point, other, non-confidential and pertinent information may be disclosed, so long as that information is not considered confidential according to the rules of professional ethics governing attorneys.

The 1999 decision of *Bolkiah v. KPMG* is one of the more important cases of recent times in this area. The concept of "Chinese walls" was more fully developed in the *Bolkiah* case where KPMG provided litigation support services for Price Jefri Bolkiah ("Prince Jefri"), Chairman of the Brunei Investment Agency ("BIA"). As a result of its services, KPMG acquired confidential information regarding Prince Jefri. During its representation of Prince Jefri, KPMG was entrusted with or acquired extensive confidential information concerning Prince Jefri's assets and financial affairs. In particular, KPMG became privy to a substantial volume of information concerning the identity of his assets, their location, the legal structure of their ownership, the identity and structure of corporate and other vehicles used by Prince Jefri to hold assets, and the

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<sup>13</sup> *Bolkiah v. KPMG*, (1998) UKHL 52; (1999) 2 AC 222; (1999) 1 All Er 517; (1999) 2 WLR 215 (16th December 1998).

manner and financing of their purchase. Altogether some 168 KPMG personnel worked on assignments for Prince Jefri between the periods of 1996 and 1998.

In June, 1998, the Government of Brunei appointed a Finance Task Force to conduct an investigation into the activities of the BIA whereby KPMG was summoned by the Ministry of Finance to Brunei to cooperate with the Finance Task Force in establishing the position of the core funds of the BIA as of May 1998. KPMG assisted the Finance Task Force in carrying out investigations into the destination and present location of monies that were subject to movements since the establishment of the BIA. Before assisting the Finance Task Force, KPMG erected a Chinese wall to provide an information barrier to protect the confidentiality of information in the possession of KPMG relating to Prince Jefri so that KPMG could act for both parties, Prince Jefri and the Finance Task Force.

First, KPMG's selection of staff to assist the Finance Task Force was intended to ensure that no one who was in possession of the confidential information relating to Prince Jefri was permitted to work with the Finance Task Force. Second, steps were taken to avoid the risk of such information becoming available to those working with the Finance Task Force in the future. Finally, KPMG ensured that the work for the Finance Task Force was carried out in a separate project room with restricted access in a building separate from that which houses the department that formerly worked on any Prince Jefri matters. In addition, separate computer file servers were used for matters involving the Finance Task Force than those that were used for Prince Jefri.

In its decision, the court held that a firm could not represent both sides of a dispute without the consent of both clients because of the "inescapable conflict of interest which is

inherent in the situation."<sup>14</sup> Despite the fact that the efforts undertaken by KPMG appeared to be comprehensive, the court granted Prince Jefri an injunction preventing KPMG from representing the Finance Task Force on the basis that courts are generally skeptical about the efficiency of Chinese walls in preserving client confidentiality. The court reasoned that while Chinese walls are well suited to prevent foreseeable or deliberate disclosure of information, they are not well adapted to deal with accidental or negligent disclosure.

Although the case recognizes the fact that courts are extremely skeptical about the effectiveness of Chinese walls as a method of dealing with actual or potential conflicts, it can be interpreted to stand for the concept that, despite such a blatant situation of conflict, there is still a window of opportunity allowing professionals to act for both sides, under their consent.

In *Bolkiah* the court suggests certain arrangements that may permit for a proper and effective Chinese wall that would permit a professional to act on behalf of both sides without any danger of disclosing confidential information. The court proposes that a firm may arrange for one of the following: (a) the physical separation of various departments in order to insulate them from each other, (b) an educational program to emphasize the importance of client confidentiality, (c) the installation of a monitoring system to review the effectiveness of the wall and (d) disciplinary sanctions where there has been a breach of the wall. Overall, the court suggested that, to be effective, the Chinese wall needs to be an established part of the organizational structure of the firm, and not created ad hoc.

When properly implemented, these measures may ensure the protection of confidential information. In this situation, a court may hold that a properly installed Chinese wall may prevent the disclosure of such confidential information and, therefore, grant such a window of opportunity allowing the professionals involved to act for both sides. Adhering to the

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<sup>14</sup> *Id.*

suggestions given in *Bolkiah*, general counsel for a target bank may install an effective Chinese wall whereby counsel would be granted the opportunity to represent his or her client, the target bank, in a merger and acquisition while participating in the due diligence of the acquiring bank. Counsel for merging banks may set up two different teams to represent two different clients participating in a merger so long as the attorneys receive informed consent from each client and an effective Chinese Wall is created.

### **iii. Direct Adverse Conflicts between Institutions**

When acting as general counsel for a bank preparing for a merger and acquisition, the general counsel must remember that any communications with the acquiring bank may adversely affect the interests of his or her existing client. The lawyer must first consider Rule 1.7(a) of the Model Rules. Under that provision, representation of a party "directly adverse to another client" is prohibited unless a lawyer concludes that his relationship with the existing client will not be "adversely affected" by the new representation, and both clients consent.<sup>15</sup>

#### **1. "Adversely Effected" - Model Rule 1.7**

The use of the term "adversely effected" in Rule 1.7(a) clearly differentiates the more general or indirect adverseness which is addressed in paragraph (b) of Model Rule 1.7. According to paragraph (b), even if the lawyer believes there is no adverse conflict between the two institutions, the target bank and acquiring bank, the lawyer must nonetheless consider whether either the existing representation or the prospective one may be "materially limited by the lawyer's responsibilities to another client or to a third person."<sup>16</sup>

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<sup>15</sup> MODEL RULES OF PROF'L CONDUCT R. 1.7 (1983); New York Disciplinary Rule 5-105; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 129 (perm. vol. 2000).

<sup>16</sup> ABA Comm. on Prof'l and Judicial Ethics, Formal Op. 95-390 (1995).

Model Rule 1.7(a) denotes that representation of one client "directly adverse to another" is prohibited unless a lawyer concludes that his relationship with one client will not be "adversely affected" by the representation of the other client or there is no significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client.<sup>17</sup> After the lawyer makes such determination, both clients must consent after there has been a "communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question."<sup>18</sup>

However, loyalty to a client is impaired not only when a lawyer undertakes a representation directly adverse to the client, but also "when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other responsibilities or interests."<sup>19</sup> Where the new representation will be either directly adverse to the current client or materially limited by the lawyer's responsibilities to the existing client, the new representation is prohibited under Model Rule 1.7(b).<sup>20</sup>

Where there is a direct adverseness, the lawyer may not take on the new representation unless two tests are met. First, the lawyer must reasonably believe that his new assignment will not adversely affect his relationship with his existing client.<sup>21</sup> The lawyer's subjective judgment is not necessarily dispositive. Rather, his belief that his existing client will not be adversely effected must be reasonable. Second, both clients must consent after "consultation," meaning a

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<sup>17</sup> MODEL RULES OF PROF'L CONDUCT R. 1.7(a) (1983).

<sup>18</sup> MODEL RULES OF PROF'L CONDUCT R. 1.7 (1983).

<sup>19</sup> ABA Comm. on Prof'l and Judicial Ethics, Formal Op. 95-390 (1995).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

"communication of information reasonably sufficient to permit the client to appreciate the significance of the matter in question."<sup>22</sup>

**b. Law Firm Considerations: Breaching Client Confidence**

As stated previously, one of the major concerns pertaining to general counsel of a bank preparing for a merger and acquisition is the potential disclosure of confidential information that may occur during the acquiring bank's due diligence process. The fundamental purpose of the attorney-client relationship and its privileges is to safeguard the relationship so as to promote the communication of confidential information between the attorney and his client.<sup>23</sup>

**i. One Law Firm Representing Both Banks**

The application of the Model Rules in the circumstances of a bank's general counsel participating in his or her client's merger and acquisition will guide the general counsel to ask some very crucial questions that must be addressed before accepting the position to represent both banks during the merger process. First, the lawyer should ask him or herself whether the acquiring bank is also a client, or entitled to be treated as so for purposes of Rule 1.7. Second, if the acquiring bank is not a client, whether the representation adverse to the acquiring bank is also "directly adverse" to the lawyer's client so as to bring it under Rule 1.7(a). Third, if the lawyer shall conclude that Rule 1.7(a) is not applicable, the lawyer should inquire whether the lawyer's responsibilities to one client or the other nonetheless materially limits the lawyer's representation so as to bring Rule 1.7(b) into play. Since a lawyer owes a duty of loyalty only to that lawyer's client, it is necessary to determine the answers to the preceding questions from the outset.

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<sup>22</sup> *Id.*

<sup>23</sup> *2,002 Ranch, LLC v. Superior Court*, 113 Cal. Ct. App. 4th 1377, 1387, 7 Cal. Rptr. 3d 197, 204 (2003).

## 1. Conflicts of Interest: Multiple Clients

As previously stated, when requested to undertake representation that may adversely affect the interests of an existing client, a lawyer must consider Model Rule 1.7. Model Rule 1.7 prohibits the representation of a client if that representation will be directly adverse to another client or a significant risk that the representation will be materially limited exists. General counsel participating in its client's potential merger and acquisition must remain especially careful not to breach the duty of loyalty he or she owes to its client.<sup>24</sup>

The primary policy underlying the bar against simultaneous representation of adverse parties is the notion that every client has the right to his or her attorney's undivided loyalty and, therefore, are assured that the exercise of the lawyer's independent professional judgment will not be impaired by loyalties to another client.<sup>25</sup>

### ii. Merger and Acquisition Transactions

There will be many situations in which a lawyer will be able to provide competent representation to multiple clients in a transactional setting, even where the interests of one client are adverse to those of another in the same transaction.<sup>26</sup> The transactional setting is unique when making ethical considerations involving concurrent clients. Unlike litigation, the ethical considerations in the transactional setting are not as clear cut.<sup>27</sup> In litigation, it is obvious that a lawyer cannot represent both sides -- "it is one of the few per se rules in the field of conflicts."<sup>28</sup>

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<sup>24</sup> See generally MODEL RULES OF PROF'L CONDUCT R. 1.13 (1983); see generally New York Disciplinary Rule 5-109; see generally RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 85 (perm. vol. 2000).

<sup>25</sup> *U.S. v. Nabisco*, 117 F.R.D. 40, 44-45 (E.D.N.Y. 1987).

<sup>26</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* citing *Simon's New York Code of Prof'l Resp. Ann.*, DR 5-1-5, at 337 (West 2000).

In contrast, the application of professional ethical codes to the representation of multiple parties is more relaxed in a transactional context. "Courts demonstrate a somewhat more benign attitude as the scene of a conflict of interest moves away from litigation and into contract and other private-ordering transactions."<sup>29</sup>

Many law firms serve clients who are requesting that the firm represent two clients with differing interests in a single transaction.<sup>30</sup> It is of fundamental importance that the right of the client to select counsel of their choice be given heavy consideration. The New York Court of Appeals has established that the right of multiple parties to utilize a single lawyer in a transaction is virtually absolute.<sup>31</sup> In its decision, the New York Court of Appeals held that the parties had an absolute right to be represented by the same attorney provided that "the attorney fairly advises the parties of both the salient issues and the consequences of joint representation...and that 'there has been full disclosure between the parties, not only of all relevant facts but also of their contextual significance, and there has been an absence of inequitable conduct or other infirmity.'"<sup>32</sup>

### **1. Determining Whether an Attorney May Fairly Represent Both Parties to the Merger Transaction**

Whether an attorney may represent multiple parties in one single transaction depends on the nature and depth of the transaction. In the case of mergers and acquisitions, the attorney

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<sup>29</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001) citing *Wolfram*, § 7.3.4.

<sup>30</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001).

<sup>31</sup> *Levine v. Levine*, 56 N.Y.2d 42, 436 N.E.2d 476 (1982) (Court permitted lawyer to represent both spouses in the preparation of a separation agreement even though the representation was fraught with potential adversity).

<sup>32</sup> *Levine v. Levine*, 56 N.Y.2d 42, 48, 436 N.E.2d 476, 479 citing *Christian v. Christian*, 42 N.Y.S.2d 63, 365 N.E.2d 849 (1977).

must question certain facts such as his or her level of involvement in the particular transaction, the nature of the merger and acquisition and his relationship with each of the clients.<sup>33</sup> In determining whether a disinterested lawyer would believe that he or she may competently represent the interest of the two simultaneously represented clients with potentially adverse interests in the same transaction, certain factors suggested by the Association of the Bar of the City of New York should be considered.<sup>34</sup>

**a. The Nature of the Conflict**

The nature of the proposed representation of multiple clients in the same merger and acquisition may dictate the outcome of whether the lawyer may represent both parties.<sup>35</sup> For instance, in the context of a takeover, the interests of the parties are inherently antagonistic and simultaneous representation will be impermissible.<sup>36</sup> On the other hand, "where a single firm serves as a mergers and acquisitions counsel to one corporation in a friendly merger and as an antitrust counsel to the other merging corporation for purposes of securing regulatory approval," the nature of the conflict will likely not prohibit effective consent.<sup>37</sup>

Under these circumstances, mergers and acquisitions counsel could represent its client without an adverse effect on its professional judgment because counsel's primary interest is the consummation of the merger on the best terms available; antitrust counsel's primary work on behalf of the other client will be in furtherance of obtaining necessary regulatory approvals for the transaction to proceed, and not on improving the terms of the deal. Because the

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<sup>33</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001).

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001).

antitrust lawyer's engagement would not be directly opposed to its own firm's efforts on behalf of the other party, informed consent could be effective.<sup>38</sup>

By the very nature of a merger and acquisition, "the conflict involved may be less direct and contentious and, therefore, more amenable to simultaneous representation with informed [and the effective] consent" of both clients.<sup>39</sup>

**b. Likelihood that Client Confidences are Relevant to Representation of the Other Client**

As discussed previously, one of the fundamental functions of the attorney-client relationship, and the privileges that accompany that relationship, is the protection of the client's confidences and secrets. To the extent that neither client's confidential information could potentially be used to the disadvantage or advantage of one client during the simultaneous representation, the concern is not implicated.<sup>40</sup>

Evidently, the nature of the transaction in which the attorney is asked to make a simultaneous representation will determine the likelihood of whether client confidences or secrets are relevant to the other client. For instance, concurrent representation in a transactional matter of one client, with interests adverse to another client in a different transactional matter, will generally not give rise to the opportunity to compromise the confidences of either client due to the dissimilarities of the two matters.<sup>41</sup> However, where the attorney is asked to represent multiple clients in the same transaction, there exists a greater likelihood that the confidences of one client are relevant to the other client. In this scenario, "the confidences and secrets of those

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

clients are clearly relevant. Nonetheless, concurrent representation is permissible where appropriate measures may be taken to protect those confidences and both clients knowingly consent."<sup>42</sup>

### **c. Safeguards to Protect Confidential Information**

To protect the confidentiality of the client's information, law firms may establish or offer "screening" procedures similar to a Chinese Wall, and other information control devices, by segregating files and creating separate legal teams.<sup>43</sup> By using such "screening" procedures, the risk of misuse of client confidences and secrets can be reduced significantly depending upon the nature of the multiple representation. For example, where the firm's mergers and acquisitions department represents one client, and its antitrust or tax department represents the other, "the likelihood of contact between a 'screened' attorney and one handling an adverse representation is normally reduced when the two groups operate in different departments within the firm."<sup>44</sup>

### **d. Abilities of Attorney to Explain, and Client to Understand, the Foreseeable Risks**

Notwithstanding safeguards that may have been put in place, "circumstances may arise where a lawyer's duty of confidentiality to one client will prevent the lawyer from being able to explain fully to the other the nature of the conflict and the material and reasonably foreseeable ways that the conflict could adversely affect the client's interests."<sup>45</sup> In these situations, "the lawyer should explain fully to each client the implications of the common representation and otherwise provide to each client information reasonably sufficient, giving due regard to the

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<sup>42</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* citing *Conflicts of Interest in Private Practice*, 94 Harvard L. Rev. 1284, 1367-68 (1981).

<sup>45</sup> The Association of the Bar of the City of New York, *Conflicts in Corporate and Transaction Matters*, Formal Opinion 2001-2 (2001).

sophistication of the client, to permit the client to appreciate the significance of the potential conflict."<sup>46</sup> Naturally, the more sophisticated the client, the more readily the client comprehends "the possible effects on loyalty and confidentiality of the simultaneous adverse representation."<sup>47</sup> For instance, when a client is represented by their own internal general counsel, it is likely that the client would be capable of consenting to the simultaneous representation, "especially where that client desires, or is demanding, that the firm do so."<sup>48</sup>

#### e. The Attorney's Relationship with the Client

Finally, both sides of the simultaneous representation will best be served where the attorney is able to properly serve both clients, meaning "the attorney's relationship with any one client cannot be so disproportionate as to create a bias in favor of one or the other."<sup>49</sup> In some situations, due to the length and nature of the relationship or the amount of fees earned by one client, the potential risk for bias exists. Restatement Third, § 121 lists several relevant factors to help determine whether a potential risk for adversity exists. In determining whether a bias exists the attorney must look to the "duration and intimacy of the lawyer's relationship with the client or clients involved, the function being performed by the lawyer, the likelihood that actual conflict will arise and the likely prejudice to the client from the conflict if it does arise; [t]he question is often one of proximity and degree."<sup>50</sup>

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<sup>46</sup> MODEL CODE OF PROF'L RESPONSIBILITY, EC 5-16; MODEL RULES OF PROF'L CONDUCT R. 1.7; New York Disciplinary Rule 5-105 (a)-(c).

<sup>47</sup> The Association of the Bar of the City of New York, Formal Opinion 2001-2 (2001).

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 cmt. c(iii) (1995).

### c. "Soft" Conflicts

The potential conflicts that may arise during multiple representation of clients are not only legal conflicts, but business, or "soft" conflicts as well. The representation of multiple clients in a single transaction, such as a merger and acquisition, may raise business conflicts. For instance, during multiple representation in a merger and acquisition, the attorney not only may potentially disclose confidential information protected by the attorney-client privilege, but may also inadvertently disclose business tactics, such as the bank's operations, plans for negotiations in light of the merger and acquisition process, or certain financial information not intended to be learned by the other party.

When representing multiple clients in a merger and acquisition, an attorney should be careful not to reveal such vital information that may be pertinent to the negotiations or tactics to the deal. In this situation the attorney must play the role not only of the ethical and diligent counsel of its client but must become business-savvy and understand his or her role during the negotiations process.

## II. Privacy Considerations

One of the major concerns of general counsel of a target institution participating in a merger and acquisition is the potential disclosure of private information of the institution's customers and consumers while the acquiring bank is participating in due diligence. In order to prevent such violation of privacy, the Federal Trade Commission in 1999 implemented measurements to protect consumers' personal financial information held by financial institutions.

## a. Gramm-Leach-Bliley Act

### i. General Provisions

The Financial Modernization Act of 1999, also known as the "Gramm-Leach-Bliley Act" ("GLB Act") imposes restrictions on how financial institutions may share nonpublic personal information with third parties and requires financial institutions to notify all customers of their privacy policy with respect to such disclosures.<sup>51</sup> The GLB Act attempts to inform individuals about the privacy policies and practices of financial institutions, so that consumers can use that information to make choices about financial institutions with whom they wish to do business.

The GLB Act entitles customers of financial institutions that disclose nonpublic information to nonaffiliated third parties to receive privacy notices automatically for every year that the customer relationship exists with the institution. The Act requires even those financial institutions that do not disclose nonpublic information about customers to nonaffiliated third parties to supply customers with a "simplified notice." Under this simplified notice, financial institutions are required to state that no such disclosures are made and are required to alert the customer of the type of information that is collected and the policies and procedures in place to protect that information.<sup>52</sup>

The GLB Act however fails to protect customers from the sharing of nonpublic private information with the financial institution's affiliates. The GLB Act does not permit customers from precluding financial institutions from sharing nonpublic personal information with affiliated companies. Rather, the GLB Act merely requires companies to notify their customers of their practices of information sharing with affiliates. In this area, the law gives consumers

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<sup>51</sup> R. Shane McLaughlin, *The Gramm-Leach-Bliley Financial Modernization Act -- Analysis and Suggestions for Reform*, 72 Miss. L.J. 1099, 1099 (2003).

<sup>52</sup> *Id.* at 1103-1104.

only limited control, via an opt-out provision, over how financial institutions use and share the consumer's person information with affiliate corporations.

### **1. "Financial Institutions"**

The GLB Act applies to "financial institutions." The term "financial institution" is broad and includes a vast array of businesses, including all businesses that have the capacity to extend credit to their customers.<sup>53</sup> The Federal Trade Commission has authority to enforce the law with respect to "financial institutions" that are not covered by the federal banking agencies, the Securities and Exchange Commission, the Commodity Futures Trading Commission, and state insurance authorities. However, the FTC's regulation applies only to companies that are "significantly engaged" in such financial activities. The following include those financial institutions which fall within the purview of the Act: retailers that extend credit by issuing credit cards, personal property or real estate appraisers, automobile dealerships who lease vehicles, career counseling service providers, businesses that print checks for individuals, businesses that wire money for individuals, check cashing businesses, accountants and tax preparation companies, travel agencies, businesses providing real estate settlement services, mortgage brokers, investment advisory companies and credit counseling services.<sup>54</sup>

### **2. "Nonpublic Personal Information"**

The GLB Act protects only that information that is nonpublic and personal to the customer or consumer. The GLB Act defines nonpublic personal information as any personally identifiable financial information as well as "(a)ny list, description, or other grouping of

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<sup>53</sup> John T. Soma, et. al., *An Analysis of the Use of Bilateral Agreements Between Transnational Trading Groups: The U.S./EU E-Commerce Privacy Safe Harbor*, 39 Tex. Int'l L.J. 171, 185 (2004).

<sup>54</sup> *McLaughlin*, supra note 52, at 1100.

consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available."<sup>55</sup>

### **3. Customer versus Consumer**

The GLB Act distinguishes between a financial institution's customers and consumers. Only customers of a financial institution are entitled to receive a financial institution's privacy notice automatically for every year that the customer relationship exists. Consumers are entitled to receive a privacy notice from a financial institution only if the company shares the consumer's information with companies not affiliated with it (including prospective merger candidates). For purposes of the GLB Act a consumer is one who obtains or obtained a financial product or service from a financial institution for personal, family or household reasons. A customer rather, is a consumer with a continuing relationship with the financial institution. Generally, if the relationship between the financial institution and the individual is significant and/or long-term, the individual is a customer of the institution.

#### **b. Application of the Act to General Counsel in the Context of Bank Merger and Acquisition Transactions**

"It remains unclear whether the privacy provisions [of the GLB Act] apply to the legal profession."<sup>56</sup> A variety of situations "can be imagined in which attorneys are required to comply with the GLB Act."<sup>57</sup> For example, the general counsel of a target bank participating in a merger and acquisition may find him or herself in a position whereby he or she is questioned as to the bank's customers or consumers. Under these circumstances, it is likely that the general

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<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

counsel of the bank would fall under the purview of the GLB Act and, therefore, would be prohibited from providing nonpublic personal information of the bank's customers or consumers.

While the legislative history of the Act does not reflect an intent to subject attorneys to its provisions, "due to the costliness of noncompliance, attorneys would be well-advised not to disregard the Act's potential applicability."<sup>58</sup> In 2002, the New York State Bar Association instituted a lawsuit against the Federal Trade Commission in the United States District Court for the District of Columbia challenging the Act's application to practicing attorneys.<sup>59</sup> In determining whether the terms of the Act applies to lawyers, the courts will have to decide on a variety of issues, including "whether the attorney-client confidentiality rules provide greater protection than the Act, whether Congress intended the Act to govern lawyers, and potential Tenth Amendment concerns over the federal regulation of attorneys."<sup>60</sup>

#### **c. Applicable Federal and State Banking Laws**

Additional federal and state laws have been implemented to protect the consumer from a violation of their financial privacy. Congress has enacted laws to protect the financial privacy of individuals as the need arose. In addition to the Gramm-Leach-Bliley Act, among the more significant acts enacted by Congress are The Fair Credit Reporting Act of 1970 and the Right to Financial Privacy Act of 1978. At the same time, the states have exercised their strong interest in protecting their citizens as consumers. Some states have enacted protections beyond those provisions in federal law offering more limited protection.

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<sup>58</sup> *Id.*

<sup>59</sup> *McLaughlin*, *supra* note 52, at 1100.

<sup>60</sup> *Id.*

## **i. Federal Banking Laws**

### **1. Fair Credit Reporting Act**

Congress enacted the Fair Credit Report Act ("FCRA") to protect consumers from the disclosure of inaccurate and arbitrary personal information held by consumer reporting agencies. While the FCRA regulates the disclosure of personal information, it does not restrict the amount or type of information that can be collected. Under the FCRA, consumer reporting agencies may only disclose personal information to third parties under specified conditions. Additionally, information may be released to a third party with the written consent of the consumer to whom the information relates or when the reporting agency has reason to believe the requesting party intends to use the information for a credit, employment, or insurance evaluation, in connection with the grant of a license or other government benefit, or for another "legitimate business need" involving the consumer.<sup>61</sup>

### **2. Right to Financial Privacy Act**

The Right to Financial Privacy Act was designed to protect the confidentiality of personal financial records by creating a statutory Fourth Amendment protection for bank records. The Right to Financial Privacy Act states that "no Government authority may have access to or obtain copies of, the information contained in the financial records of any customer from a financial institution unless the financial records are reasonably described" and (i) the customer authorizes access, (ii) there is an appropriate administrative subpoena or summons, (iii) there is a qualified search warrant, (iv) there is an appropriate judicial subpoena or (v) there is an appropriate written request from an authorized government authority.<sup>62</sup>

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<sup>61</sup> 15 U.S.C. § 1681(b) (1997).

<sup>62</sup> 12 U.S.C. § 3402 (1982).

The statute prevents banks from requiring customers to authorize the release of financial records as a condition of doing business and states that customers have a right to access a record of all such disclosures.

## **ii. State Banking Laws**

Since the enactment of the GLB Act there has been considerable activity in state legislatures on financial privacy issues, particularly in terms of legislation that would require affirmative consent for disclosing nonpublic personal information to nonaffiliated third parties.

### **1. California Financial Information Privacy Act**

In August 2003 the California Legislature enacted a law that requires financial institutions to provide their consumers with notice and a meaningful choice regarding how their nonpublic personal information is shared or sold by their financial institutions.<sup>63</sup> The intent of the California Legislature in creating the California Financial Information Privacy Act ("California Act") was to afford individuals greater privacy protections than those provided in the Gramm-Leach-Bliley Act.<sup>64</sup>

The California Act is designed to require a financial institution to obtain a consumer's permission (opt-in) before sharing non-public personal information with non-affiliated third parties. With limited exceptions, the Act provides that non-public personal information may not be shared with non-affiliated third parties in the absence of explicit prior consent from the consumer to whom the information relates. This opt-in provision is in contrast to that of the GLB Act which provides for mere notice and the opportunity for the consumer to opt-out.

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<sup>63</sup> *CA Financial Code* § 4051(a). Governor Gray Davis signed the California Financial Information Privacy Act on August 23, 2003 which became effective on July 1, 2004.

<sup>64</sup> *CA Financial Code* § 4051(b).

At the same time, the Act allows consumers to decline to permit (opt-out) the sharing of private information when a financial institution determines to share non-public personal information with an affiliate.

## **2. New Jersey Financial Information Privacy Act**

Similar to that of California, the New Jersey Financial Information Privacy Act ("New Jersey Act"), introduced January 2003, aims to protect the privacy of an individual's financial information beyond that provided by the GBL Act. The New Jersey Act, if enacted, will go beyond that of the state of California in that the New Jersey Act requires the consumer's informed, affirmative consent prior to any disclosure by a financial institution to nonaffiliate third parties as well as affiliates. The New Jersey Act requires the financial institution to specify the types of information that will be disclosed and the conditions under which it will be disclosed.<sup>65</sup> No other state has enacted a law that places such a significant burden on the financial institution.

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<sup>65</sup> New Jersey Senate Bill No. 2245 (January 16, 2003).