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Corporate Litigation:

Post-Merger Control of Attorney-Client Privilege

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When a company is acquired, who "owns" the company's pre-acquisition attorney-client privileged communications—the buyer or the seller? Last month, the Delaware Court of Chancery adopted a bright-line rule that any attorney-client privilege attached to pre-merger communications—whether they relate to business operations or the negotiation of the merger itself—pass to the acquirer in the merger, unless the parties agree otherwise in the merger agreement. In *Great Hill Equity Partners IV v. SIG Growth Equity Fund I*,[1] Delaware Chancellor Leo E. Strine Jr. rejected the New York approach to post-merger privilege enunciated by the New York State Court of Appeals in *Tekni-Plex v. Meyner & Landis*,[2] which held that the seller transfers to the buyer its privilege on most subjects but retains control of pre-merger privileged communications that relate to the merger and its negotiation.

Great Hill reminds practitioners that the parties to a Delaware law asset transaction, merger or sale of stock are free to vary by contract the automatic transfer of the seller's attorney-client privilege to the buyer. Practitioners ordinarily should take privilege and post-closing attorney representation matters into account in negotiating acquisitions. Counsel for the seller may want to insist on a contractual provision excluding pre-merger attorney-client communications regarding the negotiation of the transaction from the assets transferred to the buyer, and expressly acknowledging that the attorney-client privilege for those communications belongs solely to the seller after the merger.

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Background

The attorney-client privilege is far and away the oldest of the evidentiary privileges involving confidential communications. It predates any of the others by at least a thousand years. The purpose of the attorney-client privilege is to allow attorneys and their clients to have a full and frank exchange; by encouraging the client to speak freely, the privilege facilitates the provision of informed legal advice.[3] "You can tell me everything, it will never leave this room," is a confidence-inspiring message from a lawyer to a client.

In practice, whether a particular communication is privileged in the first place—and remain so for all time—cannot always be ascertained when the communication is made. Once we start carving out the exceptions (the communication was not made in a confidential setting, lacked a legal purpose, waiver, etc.), communications perhaps thought to be privileged may not be viewed so by a court. For example, in September 2013 the Delaware Court of Chancery in *In re Info. Mgmt. Servs., Deriv. Litig.*,[4] ruled that the attorney-client privilege does not cover corporate employees' emails with their personal attorneys where the employees communicated over company servers knowing that the company had the right to monitor all emails. Moreover, the cloak of privilege simply protects the communication from discovery; the underlying factual information contained in the communication ordinarily is not shielded from discovery.

The rule that control of a corporation's attorney-client privilege resides with current management is not new. In *Commodity Futures Trading Comm'n v. Weintraub*,[5] the U.S. Supreme Court ruled that "when control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well. New managers installed as a result of a takeover, merger, loss of confidence by shareholders, or simply normal succession, may waive the attorney-client privilege with respect to communications made by former officers and directors." A seller client's belief that attorney confidentiality may be short-lived, however, can hinder the "full and frank exchange" between attorney and client. The availability of advice from an attorney is essential if parties seeking to enter into a business combination are to negotiate effectively while adequately meeting the complexities of state and federal law; and, if that advice is to be sought and given there must be predictable certainty as to which communications will be protected.

Great Hill Case

Generally, an acquirer succeeds to all the assets, including the legal privileges, of the acquired company. Section 259 of the Delaware General Corporation Law (DGCL) provides that after a merger, all "rights, privileges, powers and franchises" of the constituent companies are vested in the surviving entity. The question in *Great Hill* was whether "all" means all: Does the transfer extend not only to pre-merger communications relating to an acquired company's day-to-day business operations, (such as contracts and disputes with suppliers, service providers, customers, etc.), but also to pre-merger communications relating to the merger itself, such as the negotiation of the merger? In *Great Hill*, the buyers acquired Plimus, an e-commerce payment processing business, in a merger. As is customary, the merger agreement provided that "the Merger shall have the effects set forth in this Agreement and in the applicable provisions of the DGCL." The merger agreement did not include a carve-out provision providing that the sellers retained any privilege regarding pre-merger communications, whether relating to the negotiation of the merger or otherwise.

After the closing, the buyers sued the sellers in the Court of Chancery, alleging fraudulent concealment of certain facts important to the buyers' assessment of the merger. The acquired company and the buyers, as owners of the acquired company and its assets (including its computers and servers), discovered documents belonging to the company that certain sellers contended were privileged and continued to belong to sellers. Buyers moved for a determination that control of any and all pre-merger privileged communications of Plimus passed to buyers in the merger.

Other Cases

Though the law on control of privilege post-merger is sparse, the Court of Chancery did not confront a blank slate. In *Tekni-Plex*, the New York Court of Appeals applied New York privilege law and divided the privileged communications of an acquired company into two categories: (i) privileged communications concerning the company's general business operations and (ii) privileged communications relating to the merger negotiations. The court emphasized that the latter were made at a time the seller was in an adversarial legal position with the buyer.

The Court of Appeals ruled that upon the closing of the merger at issue control of the seller's attorney-client communications concerning general business communications passed to the buyer, which was continuing those business operations. The privilege relating to the merger itself, however, stayed with the seller. The court noted that "to allow [buyer] access to the confidences conveyed by the seller company to its counsel during the negotiations would, in the circumstances presented, be the equivalent of turning over to the buyer all of the privileged communications of the seller concerning the very transaction at issue." This result, the court reasoned, "would thwart, rather than promote, the purposes underlying the privilege."

Chancellor Strine rejected this dichotomy, concluding that *Tekni-Plex's* carving out of the transfer to buyer communications relating to the merger was an "innovat"[ion] foreclosed by Section 259 of the DGCL. Reviewing the language of Section 259, Strine concluded that the statute's enumeration of property and assets conveyed to the buyer in a merger "uses the broadest possible terms to make sure that 'all' assets of any kind belong to the surviving corporation after a merger." The court said that "all means all as to the enumerated categories, and that this includes all privileges, including the attorney-client privilege." Consequently, "the General Assembly's statutory determination leaves no room for judicial improvisation."

The court also distinguished Vice Chancellor Donald F. Parsons Jr.'s 2008 decision in *Postorivo v. AG Paintball Holdings*,[6] which held in the context of a sale of substantially all of a company's assets pursuant to an asset purchase agreement that the seller retained control of privilege relating to pre-sale communications about certain assets and liabilities excluded from the sale by the terms of the asset purchase agreement. Strine noted that *Postorivo* applied New York law to an asset purchase agreement that excluded certain assets, rather than as in *Great Hill* "a merger that included all assets, and the [*Postorivo*] parties had agreed that under the specific contractual terms of their transaction, the seller retained the attorney-client privilege over communications relating to the negotiation of the transaction. Thus, as was the case in *Tekni-Plex*, *Postorivo* did not even cite §259 of the DGCL."

Strine observed that practitioners are accustomed to addressing by agreement the post-closing control of the seller's privileged communications relating to the negotiation of an acquisition. The chancellor observed that for years M&A practitioners have addressed privilege in merger agreements, and "the answer to any parties worried about facing this predicament in the future is to use their

contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own."

Conflicts

Though not an issue in *Great Hill*, transactional lawyers may avoid post-closing disputes about lawyer conflicts and potential disqualification motions by addressing through written waivers the extent to which the seller's counsel may represent the sellers in matters involving the company sold without running afoul of the former client conflict rule. In *Tekni-Plex*, the New York Court of Appeals disqualified the seller's long-time law firm from representing the seller in an arbitration commenced by the buyer of Tekni-Plex alleging the seller breached representations and warranties of environmental compliance contained in the merger agreement.

The firm had represented both Tekni-Plex and the seller in the merger. In its disqualification analysis, in the context of discussing whether the interests of the firm's current client (seller) and former client (Tekni-Plex) were materially adverse, the court noted that the arbitration involved issues relating to the firm's long-standing representation of the acquired company on matters arising out of the company's business operations—namely, the firm's pre-merger representation of old Tekni-Plex on environmental compliance matters. The court reasoned that any environmental violations would negatively affect not only the buyer but also the business interests of the merged corporation and that, in this regard, the interests of the firm's current client (seller) were adverse to the interests that new Tekni-Plex assumed from old Tekni-Plex.

Standing still, it is said, is the surest way of moving backward. Prior to an M&A transaction, if there is any possibility of subsequent litigation between the buyer and seller and it is considered important that the seller's transaction counsel represent the seller in such future litigation, it is worth considering structuring the acquisition agreement to include provisions to preserve the attorney-client privilege for the seller and to obtain an informed waiver of the potential conflict, i.e., to provide that in the event of a future dispute between the buyer and seller, the seller is deemed to be the holder of the attorney-client privilege for all matters prior to (and including) the transaction and that the buyer waives any right to assert the attorney-client privilege for such matters and waives any potential conflict of

interest relating to the law firm's future representation of the seller adverse to the buyer and the now-acquired company. The specifics of any conflicts waiver (including carve-outs) should be the subject of informed negotiations.

Endnotes:

1. 2013 WL 6037329 (Del. Ch. Nov. 15, 2013).

2. *Tekni-Plex v. Meyner & Landis*, 89 N.Y.2d 123 (1996).

3. *Fisher v. United States*, 425 U.S. 391, 403-04 (U.S. 1976).

4. 2013 WL 4772670, at *5-9 (Del. Ch. Sept. 5, 2013).

5. 471 U.S. 343, 349 (1985).

6. 2008 WL 343856 (Del. Ch. Feb. 7, 2008).