CORPORATE LITIGATION:

CONTROL OF THE ATTORNEY-CLIENT PRIVILEGE FOR PRE-MERGER COMMUNICATIONS

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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? Where a merger or other combination is effectuated under Delaware law, Delaware courts follow 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. Under New York law, in contrast, courts apply a rule, informed by public policy, 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. The Second Department recently addressed a variation on these divergent approaches—a New York court deciding who controls privilege when the core transaction documents contain a Delaware choice of law provision but the litigation is not brought under the transaction documents. Reversing a trial court decision, the Second Department held in *Askari v. McDermott, Will & Emery*, 2019 WL 6334192 (N.Y. App. Div. Nov. 27, 2019), that a dissolved seller and its controlling shareholder retained control over privileged pre-merger communications with their counsel because the plaintiffs' claim of replevin against their former counsel did not involve the enforcement or interpretation of any Delaware-law transaction document.

Background

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. "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 will 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, it lacked a legal purpose, waiver, etc.), communications perhaps thought to be privileged may not be viewed so by a court.

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*, 471 U.S. 343, 349 (1985), the U.S. Supreme 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

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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.

In *Tekni-Plex v. Meyner & Landis*, 89 N.Y.2d 123 (1996), the New York Court of Appeals applied New York privilege law and divided the privileged communications of an acquired company into two categories: (1) privileged communications concerning the company's general business operations and (2) 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. While the buyer controls the attorney-client privilege of the acquired business with respect to any ongoing operations, *Tekni-Plex* held, the *seller* retains control over pre-merger attorney-client communications relating to representation of the seller in the transaction.

In Delaware, the General Corporation Law provides that "all property, rights, privileges, powers and franchises, and all and every other interest" pass to the surviving or resulting corporation upon completion of a merger or combination under Delaware law. Del. Code Ann. tit. 8, §259(a). In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I*, then-Chancellor Leo Strine held that "all" means all, and interpreted §259 to mean that "the attorney-client privilege—like all other privileges—passes to the surviving corporation in the merger as a matter of law." 80 A.3d 155, 159 (Del. Ch. 2013). Thus, "the privilege over all pre-merger communications—including those relating to the negotiation of the merger itself—passe[s] to the surviving corporation in the merger, by plain operation of clear Delaware statutory law under §259 of the DGCL." Id. at 161. Finding the text of the statute unambiguous, the Court of Chancery held it could not limit the plain language of §259 to account for public policy concerns, including the risk of chilling candid pre-merger communications between attorney and client. It thus rejected the *Tekni-Plex* rule, which had addressed a Delaware corporation but did not address the language of the General Corporation Law.

The Court of Chancery has emphasized that sellers have the freedom to contract to retain aspects of the attorney-client privilege post-sale. Citing *Great Hill*, the Court of Chancery recently enforced a seller's contractual retention of privilege for communications about the transaction, barring a buyer from using pre-merger attorney-client email communications obtained in the transaction against the seller in post-closing litigation. See *S'holder Representative Servs. v. RSI Holdco*, No. CV 2018-0517-KSJM, 2019 WL 2290916 (Del. Ch. May 29, 2019).

'Askari'

In 2013, McDermott, Will & Emery represented Sina Drug, a New York corporation, in connection with the sale of substantially all of Sina's assets to PharMerica. The transaction was effectuated in part through a reorganization and transfer of ownership of Sina and related entities to Oncomed Specialty (Specialty), a Delaware entity, pursuant to a reorganization plan. Sina was "merged out" at the conclusion of the reorganization. The core transaction agreements—including the reorganization plan, a membership interest purchase agreement, and an amended and restated operating agreement—contained Delaware choice of law provisions.

Plaintiff Askari was the president and controlling shareholder of Sina, but signed the reorganization plan containing the Delaware choice of law provision solely in his individual capacity. Moreover, certain promissory notes executed on Askari's behalf in connection with the sale of his interests and an employment agreement with Specialty, contemplating that Askari was to serve as Specialty's vice chairman and chief clinical officer, contained New York choice of law provisions.

After the transactions closed, Askari requested that McDermott turn over its files concerning the restructuring as well as his employment agreement. McDermott refused, stating that under Delaware law, Sina's attorney-client privilege, as seller, had passed to Specialty, the buyer, and Specialty would need to authorize release of the files (and had not done so). Askari and Sina, the dissolved entity, subsequently filed a suit for replevin and damages under New York law.

At the summary judgment stage, the trial court enforced the Delaware choice of law provision in the membership interest purchase agreement, holding in relevant part that McDermott represented Askari only as an agent for Sina, not personally, and that under controlling Delaware law the attorney-client privilege passed from Sina to Specialty at the time of the transactions.

The Second Department reversed and granted summary judgment to plaintiffs on the replevin claim. It first held that New York law applied to the dispute, holding that the trial court erred by relying on the Delaware choice of law provision in the purchase agreement to the exclusion of other transaction documents, including the employment agreement and promissory notes (which contained New York choice of law provisions). The complaint alleged the tort of replevin, rather than a contractual claim arising under the purchase agreement or any other transaction agreement. The court also noted that in disputes over access to documents, New York applies the law of the forum where evidence will be introduced at trial or of the location of the proceeding seeking disclosure of such evidence. Under this standard, the privileged communications were sought by Askari, a New York resident, in a New York lawsuit; the communications were made in New York; and they involved New York based attorneys and a New York seller entity (Sina).

As a matter of public policy, moreover, the court opined that, under *Tekni-Plex*, "[i]t would indeed be incongruous to enforce a [Delaware] law which effectively forecloses New York corporations merging with foreign corporations from having the ability to pursue their claims against their counsel or the newly formed, post-merger entities based on the post-merger entities' control of the documents needed by the former entities to prosecute potential claims." 2019 WL 6334192, at *12.

The Second Department then held that plaintiffs had established the elements of replevin, as Askari had the right, under New York law, to request his lawyer's files on behalf of his former company, Sina (as they relate to the transaction agreements) and on his own behalf (as they relate to the employment agreement and promissory notes).

Conclusion

Askari is an important reminder that practitioners representing buyers or sellers must carefully consider what protections may (or may not) be available to their clients with respect to pre-merger communications. Under Delaware law, a contractual provision excluding from the assets transferred to the buyer specified categories of privileged communications (such as those relating to the negotiation of the transaction) is easy to draft, and lends the clarity and predictability essential to encourage full and frank communication between attorneys and their clients. *Askari* underscores that reliance on Delaware's default rules does not obviate the need for careful drafting and pre-transaction planning. New York's preference for the seller's retention of post-closing control of pre-merger communications about the transaction may lead New York courts to search the record for New York connections to the transaction and the post-closing claim as a reason to apply New York's seller-protective rule, even where the target is organized under Delaware law or the transaction was governed, at least in part, by transaction agreements with Delaware choice of law provisions.