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Protecting Privileged Communications After a Corporate Transaction

The failure of transacting parties to determine how attorney-client privileged communications should be handled post-closing may result not only in confusion, but in litigation between the parties and potentially having to relinquish privileged material. Companies involved in corporate transactions should take steps to ensure that they, rather than a court, will be the final arbiter of who owns the privilege.

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Courts have taken a variety of approaches to determining who owns the pre-transaction attorney-client privilege after a merger, asset sale or other similar corporate transaction. Therefore, it is in the interests of both the seller and buyer to understand and account for how these communications should be treated post-closing.

This article examines the issues raised by attorney-client communications in corporate transactions, specifically:

- Privileged pre-transaction communications under Delaware and New York law.
- The practical consequences approach to privileged pre-transaction communications.
- What companies involved in a transaction should do to protect attorney-client communications.

PRIVILEGED PRE-TRANSACTION COMMUNICATIONS UNDER DELAWARE AND NEW YORK LAW

The principle that privileged communications may pass on to new management in the context of a change of corporate control is well established. In *Commodity Futures Trading Commission v. Weintraub*, the US Supreme Court noted 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" (*471 U.S. 343, 349 (1985)*). However, two key state jurisdictions to consider the issue of who owns pre-merger privileged communications after a merger have reached seemingly conflicting results.

THE DELAWARE COURT OF CHANCERY'S APPROACH

In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, the Delaware Court of Chancery held that a surviving corporation owns and controls any attorney-client privilege that might attach to pre-merger communications (*80 A.3d 155, 162 (Del. Ch. 2013)*).

This action came before the court after Great Hill Equity Partners IV, Fremont Holdco, Inc. and Bluesnap, Inc. (collectively, Buyer) brought suit against Plimus, Inc. (Seller) for fraudulently inducing the Buyer to acquire the Seller in 2011. After filing this lawsuit, and a full year after the merger, the Buyer notified the Seller that certain communications between the Seller and its then legal counsel regarding the transaction were among the files on the Seller's computer system that the Buyer acquired during the merger. During the year following the transaction, the Seller had not taken any action to get these records back from the Buyer, nor had it taken any steps pre-merger to either segregate these communications or remove them from the computer system, the control over which passed to the Buyer after the merger. The parties also did not account for these communications in any of the merger documents.

Once the Seller was notified of the existence of these communications, the Seller asserted the attorney-client privilege on the grounds that it, and not the Buyer, retained control of the attorney-client privilege over communications regarding negotiation of the merger agreement. Therefore, the central issue before the court was whether the surviving corporation owned and controlled the Seller's pre-merger privileged communications.

Because the merger agreement provided for the application of Delaware law, the Delaware Court of Chancery noted that the answer to this question was a matter of statutory interpretation. The applicable Delaware statute, Delaware General Corporation Law (DGCL) Section 259, provides that following a merger, "all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation…" (*8 Del. C. § 259*).

In applying this statutory provision, the court:

- Rejected the Seller's argument that the statutory term "privilege" only referred to property rights and did not extend to evidentiary privileges, finding that this was not a "plausible interpretation of the plain statutory language."
- Distinguished a prior Delaware Court of Chancery decision, as well as a New York Court of Appeals decision, primarily on the grounds that those cases did not cite, let alone apply, DGCL Section 259 (see below *The New York Court of Appeals' Approach* and *Practical Consequences Approach*).
- Found that the plain terms of the statutory language were clear and left no room for judicial interpretation.
- Rejected the Seller's contention that giving effect to DGCL Section 259 would create serious public policy issues, stating that "when the General Assembly has addressed an issue within its authority with clarity, there is no policy gap for the court to fill."

(*Great Hill Equity Partners IV, LP, 80 A.3d at 156-60*.)

As a result, the court held that the attorney-client privilege over all pre-merger communications, like all other privileges, passes to the surviving corporation in a merger as a matter of Delaware statutory law. The court noted, however, that parties to a merger agreement can, and have, negotiated special contractual agreements to prevent privileged information from transferring to the surviving corporation in the event of a merger (see below *What Companies Can Do to Protect the Privilege*).

THE NEW YORK COURT OF APPEALS' APPROACH

The New York Court of Appeals has come to a different conclusion regarding how pre-merger attorney-client communications should be treated. Under New York law, determining who has control over pre-merger attorney-client privileged communications post-merger depends on the nature and purpose of the communications.

In *Tekni-Plex, Inc. v. Meyner & Landis*, Tekni-Plex, and its sole shareholder, Tom Y. C. Tang, entered into a merger agreement with TP Acquisition Company (TP Acquisition), in which Tang sold Tekni-Plex to TP Acquisition, conveying to it all tangible and intangible assets, rights and liabilities (*89 N.Y.2d 123, 128 (N.Y. 1996)*). TP Acquisition became the surviving corporation and changed its name to Tekni-Plex, Inc. (new Tekni-Plex). Several months after the merger, new Tekni-Plex commenced an arbitration against Tang alleging breach of representations and warranties contained in the merger agreement regarding old Tekni-Plex's compliance with environmental laws.

One of the issues before the court was whether confidential communications between old Tekni-Plex and its counsel generated during the law firm's prior representation of the company on environmental compliance matters passed to new Tekni-Plex. In evaluating this issue, the court separated these communications into two categories:

- General business communications.
- Communications relating to the merger negotiations.

With respect to general business communications, the court found that new Tekni-Plex's management continued the business operations of the pre-merger entity. Control of the attorney-client privilege with respect to business operations therefore passed to the new management and new Tekni-Plex had the authority to assert the attorney-client privilege to preclude disclosing the contents of these communications. (*89 N.Y.2d at 136-37.*)

However, with respect to communications arising out of the merger negotiations, new Tekni-Plex did not succeed to old Tekni-Plex's right to control the attorney-client privilege. The court found that:

- New Tekni-Plex's claims did not derive from the rights it inherited from old Tekni-Plex, but from the rights retained by the buyer, TP Acquisition, with respect to the transaction.
- Under the merger agreement, the rights of old Tekni-Plex with regard to disputes arising from the merger transaction remained independent from, and actually adverse to, the rights of the buyer. Therefore, during the dispute, new Tekni-Plex could not both pursue the rights of TP Acquisition and assume the attorney-client privilege of the buyer's adversary, old Tekni-Plex.
- Because one individual, Tang, solely owned and managed the seller company, allowing new Tekni-Plex access to the confidences conveyed by the seller to its counsel during the negotiations would be the equivalent of turning over to the buyer all of the seller's privileged communications concerning the very transaction at issue. Under these circumstances, granting new Tekni-Plex control over the attorney-client privilege as to communications concerning the merger would thwart, rather than protect, the purposes underlying the privilege.

(*89 N.Y.2d at 138-39.*)

PRACTICAL CONSEQUENCES APPROACH

As discussed above, Delaware and New York courts have taken different approaches to determining ownership of pre-merger attorney-client communications post-closing. In general, however, the trend emerging seems to follow a "practical consequences" approach, which focuses on the degree of control transferred in the transaction rather than the particular mechanics of the transaction.

Under this approach, the authority to assert or waive the attorney-client privilege will follow to the new owner if the practical consequences of the transaction result in both:

- The transfer of control of the business.
- The continuation of the business under new management.

(*Soverain Software LLC v. Gap, Inc., 340 F. Supp. 2d 760, 763 (E.D. Tex. 2004) (citing Weintraub, 471 U.S. at 349)*; see also *John Crane Prod. Solutions, Inc. v. R2R & D, LLC, No. 11-CV-3237, 2012 WL 3453696 (N.D. Tex. Aug. 14, 2012)*; *Parus Holdings, Inc. v. Banner & Witcoff, Ltd., 585 F. Supp. 2d 995, 1002 (N.D. Ill. 2008)*; *Goodrich v. Goodrich, 960 A.2d 1275, 1283 (N.H. 2008)*; *Coffin v. Bowater Inc., No. 03-cv-227, 2005 WL 5885367 (D. Me. May 13, 2005).*)

Notably, in contrast to its 2013 ruling in *Great Hill Equity Partners*, the Delaware Court of Chancery, quoting *Tekni-Plex, Inc.*, had earlier found that whether the attorney-client relationship transfers to new owners "'turns on the practical consequences rather than the formalities of a particular transaction'" (*Postorivo v. AG Paintball Holdings, Inc., No. 2991-VCP, 3111-VCP, 2008 WL 343856, at *5 (Del. Ch. Feb. 7, 2008)*). When a successor merely purchases assets and does not attempt to continue the pre-existing operation, generally the attorney-client privilege does not transfer. Where, however, a successor continues the operations of the predecessor company, the successor company stands in the shoes of prior management and holds the privilege with respect to communications regarding the company's operations. (*Postorivo, 2008 WL 343856, at *5.*)

In *Postorivo*, the Delaware Court of Chancery ultimately split the privileged communications into three categories:

- The post-acquisition entity held the attorney-client privilege for all communications impacting the ongoing business, including documents and communications that occurred or were created before the asset purchase agreement.
- The seller owned the privilege covering communications regarding the negotiation of the asset purchase agreement.
- The seller owned the privilege relating to the assets and liabilities it retained.

(*Postorivo, 2008 WL 343856, at *1.*)

The Delaware Court of Chancery's more recent ruling distinguished this approach by noting that the *Postorivo* court

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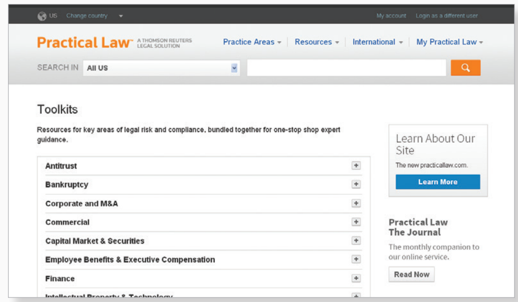
ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE TOOLKIT

The Attorney-Client Privilege and Work Product Doctrine Toolkit available on practicallaw.com offers resources designed to help attorneys maneuver the various privilege and secrecy rules throughout the US and the world. It features a range of continuously maintained resources, including:

- Asserting the Attorney-Client Privilege and Work Product Protection
- Attorney-Client Privilege: Identifying the Attorney and the Client
- Work Product Doctrine: Basic Principles
- Privilege Waiver Clause with Claw-back Provision
- Attorney-Client Privilege and Work Product Doctrine Checklist: Litigating the Protections



was actually applying New York law, rather than DGCL Section 259 (see *Great Hill Equity Partners IV, LP, 80 A.3d at 158*).

Nonetheless, it appears that, absent a specific statute covering the issue, the trend in this area leans towards adopting a more practical approach based on the degree of control transferred and the specific circumstances of a transaction, particularly as corporate transactions become more inventive and complicated.

Search Attorney-client Privilege: Identifying the Attorney and the Client for more on passing on the attorney-client privilege in certain types of transactions.

WHAT COMPANIES CAN DO TO PROTECT THE PRIVILEGE

Given the focus on the specific facts of each transaction and the lack of a bright-line rule as to which entities will control the attorney-client privilege after a corporate transaction, companies should be proactive and account for what will happen to attorney-client communications post-closing. Specifically, companies should:

- **Determine under which state law the agreement is governed and whether there is an applicable statute.** This is important because the approach used to evaluate whether potentially privileged pre-closing documents pass to new owners may vary between jurisdictions. Depending on the relevant case law, a party should be prepared to articulate the degree of control transferred as a result of the transaction and understand how that transfer of control also may impact control over the seller's privileged communications.
- **Consider which categories of communications are particularly sensitive to disclosure.** Communications with counsel fall under different categories, with some being more sensitive to disclosure than others. For example, a seller may have a greater interest in retaining the privilege depending on whether the communications relate to pre-transaction issues, the transaction itself or to ongoing business matters. The seller should consider how these communications could be used in the future should it lose control over the privilege, particularly where there is a risk of litigation being brought by the buyer or a third party regarding business conducted pre-merger.
- **Take permissible proactive steps to indicate that certain communications are privileged.** If the selling company wishes to retain control of the attorney-client privilege over communications regarding the transaction or other sensitive matters, it should take permissible proactive steps to indicate to the buyer that these communications are privileged, so there is no confusion as to the party's intentions. Although the buyer may challenge the seller's claim over the privilege, where the selling company does not treat the communications as privileged it is unlikely that a court will treat them as such. Steps may include:
  - removing or segregating these communications from the company's computers before the transfer occurs;
  - ensuring that physical documents or other materials that contain privileged information regarding the merger are also segregated; and
  - clearly informing the buyer of the intention to withhold these documents on the grounds that they contain privileged information.
- **Determine the monetary value of attorney-client communications.** As part of the merger negotiations, the seller and buyer should determine the monetary value of the attorney-client communications (as they would value every other asset of the business). The seller can potentially extract a price to agree to turn over the communications or can pay the buyer to avoid passing on these communications with the transfer of the business.
- **Specify in the agreement which entity and what types of communications will retain control of the privilege post-closing, to the extent allowed under applicable law.** As noted by the *Great Hills Equity Partners* court, "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" (*80 A.3d at 161*).