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Attorney-Client Privilege in M&A Deals: Preserving and Controlling the Privilege

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Today's faculty features:

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SEYFARTH SHAW

Attorney-Client Privilege in M&A Deals: Lessons from Recent Cases for Preserving and Controlling the Privilege

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SEYFARTH SHAW

PRE-CLOSING PRIVILEGE ISSUES

Basic Elements of Attorney-Client Privilege

- A communication;
- Made between eligible persons (*i.e.*, attorney, client or agent);
- In confidence; and
- For the purpose of obtaining or providing legal assistance for the client.

Restatement (Third) of the Law Governing Lawyers § 68.

Work-product Doctrine

- Under the work-product doctrine, "tangible material or its intangible equivalent" that is collected or prepared in anticipation of litigation is not discoverable.
- Work product not absolute privilege
- If the party unable to obtain the information has no other means of obtaining the information without undue hardship, privilege will not apply.
- The materials may have been prepared by anybody as long as they were prepared with an eye towards the realistic possibility of impending litigation.
- Originated with *Hickman v. Taylor*

Attorney-Client Privilege Issues in M&A Deals

- The attorney-client privilege is usually waived when a communication is disclosed to a third party.
- This raises issues in M&A deal settings because companies in the course of these transactions generally disclose sensitive information to prospective deal parties and to other members of the transaction team, such as investment bankers, other financial advisors and consultants.
- The common interest doctrine serves to protect such confidential communications. The doctrine generally allows "persons who have common legal interests to coordinate their positions without destroying the privileged status of their communications with their lawyers." Restatement (Third) of the Law Governing Lawyers § 76 cmt. b. However, the scope of that protection varies depending on jurisdiction.

History of the Common Interest Doctrine

- The common interest privilege is an expansion of the attorney-client privilege, which protects from disclosure confidential communications made for the purpose of providing legal advice between an attorney and his or her client. *See Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981).
- Courts initially developed the precursor to the common interest doctrine—the joint defense privilege—to allow the attorneys of criminal co-defendants to share confidential information about defense strategies without waiving the privilege. *See Chahoon v. Commonwealth*, 62 Va. 822, 841-42 (1871).
- In 1942, the Minnesota Supreme Court extended the joint defense privilege from the criminal to the civil context in finding that co-defendants in a personal injury suit do not waive the attorney-client privilege by making disclosures to counsel representing co-defendants on the same side of the same litigation. *See Schmitt v. Emery*, 2 N.W.2d 413, 416 (Minn. 1942).
- Once the doctrine spread to the civil context and began to protect plaintiffs as well as defendants, most courts adopted the broader term "common interest doctrine."

Preserving Privilege – The Common Interest Doctrine

In order for the common interest privilege to apply, the parties must show that:

- (1) the communication is protected by attorney-client privilege and
- (2) the communication is made in order to further a legal interest or strategy common to the parties. *See, e.g., Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 27 N.Y.3d 616, 625 (2016).

- Communications concerning business or commercial issues are not privileged even if the parties to the communication have a common interest. *See, e.g., In re Quest Software Inc. Shareholders Litig.*, No. CV 7357-VCG, 2013 WL 3356034, at *4 (Del. Ch. July 3, 2013).
- Questions about the applicability of the common interest privilege frequently arise because (1) individuals often play both business and legal roles in transactions and (2) conversations often cover both business topics and legal advice or legal strategy.

Preserving Privilege – The Common Interest Doctrine

Since 1980, Delaware has had a codified common interest privilege as follows:

- "A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client . . . (3) by the client or the client's lawyer or a representative of the lawyer to a lawyer or a representative of a lawyer representing another in a matter of common interest." Del. R. Evid. 502(b)(3).

Preserving Privilege – The Common Interest Doctrine

Delaware Reads Common Interest Broadly

- *In re Quest Software Inc. S'holders Litig.*, 2013 WL 3356034 (Del. Ch. July 3, 2013)
  - Quest shareholders sought the discovery of documents from Quest, including unredacted versions of all notes, minutes and draft minutes of the special committee meetings regarding the merger at issue in the litigation.
  - Shareholders argued that Quest had waived the attorney-client privilege over these communications by disclosing them to third parties, including counsel for Morgan Stanley, the financial advisor for the Special Committee.
  - The Delaware Chancery Court, however, ruled that these documents were protected by the common interest doctrine, because "the parties all shared a *legal* interest in the potential legal risk" of accepting the deal at issue.

Preserving Privilege – The Common Interest Doctrine

Delaware Reads Common Interest Broadly (continued)

- Delaware law "sanctions the privilege's application to attorney-client communications including an investment banker, especially within the context of a pending transaction," where the discussions "involved legal issues regarding the transaction." *3Com Corp. v. Diamond II Holdings, Inc.*, 2010 WL 2280734, at *4-6 & n.18 (Del. Ch. May 31, 2010).
- Analysis depends on whether parties' positions were adverse to each other "at the time each challenged communication was made. If the parties were in common interest with respect to the matters addressed, the communication will remain privileged." *Id*. at *8.

Preserving Privilege – The Common Interest Doctrine

New York Reads Common Interest Narrowly

- *Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 27 N.Y.3d 616 (2016).
  - Faced with a conflict between the First and Second Departments on the application of the common interest doctrine, the New York Court of Appeals followed the Second Department approach in a lengthy 4-2 decision in which it limited the common interest privilege to situations involving *actual or reasonably anticipated litigation*.
  - In doing so, it reversed the First Department's 2014 ruling that the common interest privilege could apply to preclosing communications between Bank of America and Countrywide and their counsel where the parties (a) signed a merger agreement without contemplating litigation; (b) signed a confidentiality agreement governing preclosing exchanges of information; and (c) needed shared advice of counsel "in order to accurately navigate the complex legal and regulatory process involved in completing the transaction."

Preserving Privilege – The Common Interest Doctrine

New York Reads Common Interest Narrowly (continued)

- *Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 27 N.Y.3d 616 (2016).
  - The New York Court of Appeals rejected Bank of America's argument that the failure to adopt a broader interpretation of the common interest doctrine closer to that of Delaware and many federal courts would have adverse policy consequences for the State of New York.
  - The Court did, however, raise in a footnote the prospect of the legislature following in Delaware's footsteps by codifying a more expansive version of the common interest privilege.
- Note: The New York City Bar's 2019 legislative agenda includes a proposal to revise New York's statute on the attorney-client privilege specifically in response to the *Ambac* decision. The proposed language would ensure that the common interest privilege will include communications between lawyers and clients sharing a common legal interest in a transactional setting.

Avoidance of Pre-Closing Privilege Waiver

- Know the law of your jurisdiction
- Be cautious about discussions involving both legal and business issues
- Keep in mind that application of the common interest privilege is highly fact specific and will depend on the specific circumstances of each situation
- A signed merger agreement increases the likelihood that privilege will apply
- Execute a common interest agreement
- Limit participating non-legal personnel as much as feasibly possible in discussions as to which a claim of privilege may be asserted.

Attorney-Client Privilege in M&A Deals

February 21, 2019

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Post-Closing Privilege Issues

Attorney-Client Privilege in M&A Deals

- General Rule
  - The attorney-client privilege belongs to and remains with the corporation
  - When there is a change of control of the corporation, the attorney-client privilege will belong to the successor corporation
  - New management will have the power to assert and waive the attorney-client privilege
- Section 259 of the DGCL

Attorney-Client Privilege in Asset Sales

- The sale or transfer of a corporation's assets, without more, generally does not transfer the privilege
- The majority of recent cases look to the "practical consequences" rather than the formalities of the transaction
  - Based on totality of the circumstances
  - Examined on a case-by-case basis

Examples of Practical Consequences Approach

- Privilege remains with seller
  - *Postorivo v. AG Paintball Holdings, Inc.*, No. 2991-VCP, 2008 WL 343856 (Del. Ch. Feb. 7, 2008)
  - *Sobol v. E.P. Dutton, Inc.*, 112 F.R.D. 99 (S.D.N.Y. 1986)
- Privilege transfers to buyer
  - *Parus Holdings, Inc. v. Banner & Witcoff, Ltd.*, 585 F. Supp. 2d 995 (N.D. Ill. 2008)
  - *Soverain Software LLC v. The Gap, Inc.*, 340 F. Supp. 2d 760 (E.D. Tex. 2004)
  - *SimpleAir, Inc. v. Microsoft Corp.*, No. 2:11-cv-416, 2013 WL 4574594 (E.D. Tex. Aug. 27, 2013)
  - *U.S. v. Adams*, No. 0:17-CR-00064, 2018 WL 1255003 (D. Minn. Mar. 12, 2018)

Transaction Communications

- Attorney-client privilege between seller and its counsel regarding the deal
- Control of the privilege becomes an issue in litigation between the buyer and seller regarding the deal
- If buyer controls the privilege, it would be entitled to use against the seller the seller's pre-merger communications with its counsel
- Two approaches to privilege for transaction communications – the New York Rule and the Delaware Rule

New York Rule

- Exception to the general rule that control of the attorney-client privilege transfers to the new management
- For privileged communications relating to the deal negotiations, control of the privilege stays with the seller after closing
- *Tekni-Plex, Inc. v. Meyner & Landis*, 89 N.Y.2d 123 (1996)
- *Orbit One Communications, Inc. v. Numerex Corp.*, 255 F.R.D. 98 (S.D.N.Y. 2008)
- *Safeco Ins. Co. of Am. v. M.E.S., Inc.*, 289 F.R.D. 41 (E.D.N.Y. 2011)
- *Facebook, Inc. v. ConnectU, Inc.*, No. C 07-01389, 2009 WL 10680755 (N.D. Cal. Sept. 2, 2009)

Delaware Rule

- Control of any privileged communications, including those between seller and its counsel related to merger negotiations, passes to the acquirer unless the parties agree otherwise in the merger agreement
- Based on Section 259 of DGCL
- *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 80 A.3d 155 (Del. Ch. 2013)
- *Novack v. Raytheon Co.*, 32 Mass. L. Rptr. 382 (Mass. Supr. Ct. 2014)
- *Newspring Mezzanine Capital II, L.P. v. Hayes*, No. 14-1706, 2014 WL 6908058 (E.D. Pa. Dec. 9, 2014)

Waiver of Privilege

- Generally, knowing disclosure of privileged communications to a third party will waive the attorney-client privilege
- M&A deals usually involve transfer of computers and servers that house privileged communications
- Does transfer of those computers and servers to the buyer post-closing waive privilege?

Waiver of Privilege

- Courts have held that transfer of computer/server does waive privilege
- Privilege waived as to buyer
  - *Kaufman v. Sungard Invest. Sys.*, 05-cv-1236, 2006 WL 1307882 (D.N.J. May 10, 2006)
  - *Current Medical Directions, LLC v. Salomone*, No. 600941/06, 2010 WL 724686 (N.Y. Sup. Feb. 2, 2010)
- Privilege waived as to third parties
  - *Society of Professional Engineering Employees in Aerospace v. Boeing Co.*, No. 05-1251, 2010 WL 3083536 (D. Kan. Aug. 5, 2010)

Avoidance of Post-Closing Privilege Waiver

- To preserve the privilege, an effort must be made to prevent disclosure of privileged communications to the buyer
  - Include provisions in the agreement to preserve the attorney-client privilege, *but see Zenith Electronics Corp. v. WH-TV Broadcasting Corp.*, No. 01C4366, 2003 WL 21911066 (N.D. Ill. Aug. 7, 2003); *Sentinel Offender Services, LLC v. G4S Secure Solutions, Inc.*, No. 14-298, 2015 WL 13546228 (C.D. Cal. Sept. 3, 2015)
  - Take steps to identify, isolate, and remove privileged communications before transferring computer/server to buyer
  - Removal of privileged communications does not necessarily need to be done upon transfer of title, but it should be done prior to the time the purchaser has ready access to the computer system. *Orbit One Communications, Inc. v. Numerex Corp.*, 255 F.R.D. 98 (S.D.N.Y. 2008)