

# Client Alert

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## In Delaware, Privilege Goes to the Buyer

### Court Finds Buyer Controls Attorney-Client Privilege over Seller's Pre-Closing Communications Regarding Merger Negotiations, Unless Otherwise Agreed

By Michael O'Bryan and Alexa Belonick

The Delaware court of chancery held recently that control over a target company's attorney-client privileged communications, including communications between the target company's counsel and its pre-merger stockholders, passes to the acquiror upon the closing of the merger. *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP* (Del. Ch. Nov. 15, 2013). As a result, the former stockholders of an acquired company were barred from asserting the attorney-client privilege over merger-related communications with the company's legal counsel that the buyer discovered on the company's computer systems after the closing of the merger.

The court noted, however, that the parties could have provided for a different result by contract through an appropriate provision in the merger agreement or other agreement.

#### BACKGROUND

A buyer acquired a company through a merger in which the target company survived. Over a year later the buyer sued the company's former stockholders for fraudulent inducement. The buyer also notified the former stockholders that it had found on the company's computer systems communications, regarding the merger, between the former stockholders and the legal counsel for the company in the merger.

The former stockholders attempted to prevent the buyer's use of the communications in litigation by asserting attorney-client privilege, claiming that they, and not the surviving company, retained control of the privilege over the company's communications regarding the negotiation of the merger agreement. The former stockholders cited cases<sup>1</sup> in which courts had distinguished between communications regarding general business operations and communications relating to merger negotiations, with privilege over the former passing to the surviving company and privilege over the latter remaining in the control of the target company stockholders.

#### COURT FINDS PRIVILEGE CONTROLLED BY BUYER

**Application of Delaware Merger Statute.** The court cited the Delaware General Corporation Law, which provides that, following a merger, "all property, rights, privileges, powers and franchises ... shall be thereafter as

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<sup>1</sup> *Tekni-Plex, Inc. v. Meyner & Landis*, 674 N.E.2d 663 (N.Y. 1996) and *Postorivo v. AG Paintball Holdings, Inc.* (Del. Ch. Feb. 7, 2008) (applying *Tekni-Plex* as New York law in the context of an asset purchase).

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effectually the property of the surviving ... corporation as they were of the several ... constituent corporations....”<sup>2</sup> The court found that the plain meaning of the statute was that the attorney-client privilege held by the target company before the merger, along with all the other privileges and specified assets of the target company, passed to the surviving company; in short, with respect to the categories enumerated in the statute, “*all means all*” (emphasis by the court). The court declined to follow the distinction made in the cases cited by the former stockholders, saying that how Delaware law addressed the issue was a question of statutory interpretation and refusing to “invent a judicially-created exception to the plain words ‘all . . . privileges.’”

**Ability to Negotiate Contractual Protections.** The court noted, though, that parties can negotiate contractual agreements to specify who will own or control different aspects of the privilege. The court referred to several examples of such provisions that the buyer had submitted. The court also noted that one of the cases cited by the former stockholders<sup>3</sup> involved an asset sale in which the parties had excluded from the sale all of the seller’s rights under the sale agreement and related agreements, and had agreed that the seller retained the privilege over communications relating to the negotiation of the sale, although the parties later disputed the scope of the retained privilege.

**Potential for Inadvertent Waiver.** Since the court decided that the privilege belonged to the buyer, it did not need to decide whether the selling stockholders had waived any privilege by allowing the buyer to have access to the communications. However, the court described the sellers’ “lengthy failure to take any reasonable steps to ensure the [b]uyer did not have access to the allegedly privileged communications” as a “substantial issue.”

## IMPLICATIONS

- **In Delaware, Privilege Goes to the Buyer.** The decision clarifies that, in Delaware, the default rule is that the attorney-client privilege over communications by a target company acquired in a merger is controlled by the surviving company and thus, by extension, the buyer.
- **Drafting Agreements to Change Default Result.** Parties should consider specifying in their merger agreement or other agreement who will control the attorney-client privilege post-closing, particularly with respect to communications regarding the transaction. This is more significant in acquisitions of private companies, where the selling stockholders typically bear some post-closing liability for breaches of reps and warranties and other indemnities, than in acquisitions of public companies. The same or a similar provision also can be used by sellers to protect potentially sensitive communications, like those relating to pending or potential litigation, even if not necessarily included under the attorney-client privilege.
- **Avoiding Inadvertent Waiver.** Sellers should consider taking measures to protect communications and avoid inadvertent waivers of the privilege. Such steps could include, to the extent consistent with obligations under the acquisition agreement, removal of privileged communications stored on the company’s servers before closing and establishment of separate email accounts for communications related to the merger negotiations.

<sup>2</sup> Sec. 259. The target company was a California corporation, but the buyer used a Delaware corporate vehicle, and the former stockholders did not argue that California law had a different effect. The merger agreement also included a Delaware choice of law provision.

<sup>3</sup> *Postorivo*.

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- **Anticipating Attorney Disqualification Issues.** Though not addressed in *Great Hill*, similar issues can arise when former stockholders after an acquisition try to use their or the target company's former counsel, such as in response to a buyer's claim of breach of reps and warranties in the acquisition agreement, only to find the counsel conflicted due to their prior work for the target company. In *Tekni-Plex*, for example, the surviving company was able to disqualify the law firm that represented the selling stockholder in the acquisition and in the target company's pre-closing activities from representing the selling stockholder in a post-closing claim by the buyer relating to some of those prior activities. Selling stockholders should consider adding provisions to the merger agreement or other agreement to preserve their right to engage such counsel, although buyers may resist such provisions.

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