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Caution: Not Taking Proper Precautions When Handling Client-Attorney Privilege in a Sale or Merger Could Have Major Consequences

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You have represented a dealership and its owner for years when the owner decides to sell the dealership. The owner asks you to represent the dealership in the negotiations, sharing with you his less-than-favorable opinion of the acquiring owner, problematic relationships that may arise with dealership employees, and the like. After the sale is complete, you receive a polite email from counsel for the new owner, announcing that she is now counsel for the dealership. She asks you to immediately forward all files and communications from the prior owner. As this article explains, unless you have taken proper precautions, your client and you could face embarrassing and expensive consequences.

Recent case law indicates that when a corporation is acquired, the corporation's attorney-client privilege will typically belong to the buyer. This is because the privilege belongs to the corporation as the client, and thus the privilege passes with the corporation.[1] Because of this, a selling shareholder may have no right to assert a claim of privilege after an asset sale, merger, or other similar corporate transaction is completed. There is some controversy over whether pre-transaction communications regarding the transaction itself pass to the buyer or surviving corporation. On the other hand, pre-transaction communications made in the general course of business are generally agreed to belong to the acquirer unless explicitly carved out.

One of the leading cases addressing this issue is the New York case *Tekni-Plex, Inc. v. Meyner & Landis,* 89 N.Y.2d 123, 651 N.Y.S.2d 954, 674 N.E.2d 663 (1996). *Tekni-Plex* involved the sale of a corporation, which was structured as a merger of the corporation being acquired into a shell acquisition corporation. *Id.* 89 N.Y.2d at 128. A law firm represented both the owner of the selling corporation and the selling corporation itself. *Id.* The privilege dispute arose when the buyer brought suit against the seller after the acquisition had been completed. *Id.* The buyer alleged breach of representation and warranties and demanded all files relating to the firm's prior representation of the old entity. *Id.* at 129. Although the seller argued that it retained the right to the privileged communications of the old entity, the court held that all privileges passed from the old corporation to the acquiring corporation, except for pre-merger communications relating to the merger. *Id.* at 138-39.

Other cases have eliminated even the narrow exception for pre-transaction communications relating to the transaction itself that *Tekni-Plex* carved out. Notably, the Delaware Court of Chancery recently rejected the exception in the case *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP,* 80 A.3d 155 (Del. Ch. 2013). In *Great Hill,* after the completion of a merger, the buyer brought an action against the seller for fraudulently inducing the buyer to acquire the company. The seller had not taken any steps to preserve or conceal the privileged information from the change in control of the corporation. *Id.* at 156. The court held that all of the attorney-client privilege passed to the surviving corporation, including the privilege related to the communications about the transaction itself. *Id.* at 159. However, the court acknowledged that by providing provisions within the merger agreement, the seller's pre-merger privilege could have been protected. *Id.* at 101.

The rule may differ where there is merely the purchase of assets, with no continuation of the pre-existing business operation. See *Orbit*

[1] A large part of the problem arises from the unique issues associated with dual representation of the dealership and the owner, and the possibility of those interests being in conflict. Under the ABA Model Rules, when the client is an organization, the attorney's duty is to the organization as an entity, and not to its constituents. See Rule 1.13. However, the Model Rules allow for dual representation, subject to compliance with Model Rule 1.7 and 1.13. In practice, it is common for an attorney to represent both the selling shareholder(s) and the corporation in these types of transactions where the company is owned by one shareholder or a small group of shareholders. The general issues relating to dual representation are outside the scope of this article. Before agreeing to represent both a shareholder and corporation in the transaction, an attorney should always ensure he is in compliance with the ethical rules for dual representation in the jurisdiction. The attorney should also assess possible conflicts and the likelihood that those conflicts may manifest.

One Comms., Inc. v. Numerex Corp., 255 F.R.D. 98 (S.D.N.Y. 2008). In *Orbit One,* the seller sold all assets and rights of the company in order that the buyer could continue the operations. *Id.* Because the rights and assets transferred under the asset purchase agreement included all rights the court held that the privilege covering the seller's pre-transaction communications in the regular course of business belonged to the buyer. *Id.* at 106. The court held the seller retained the pre-transaction privilege only with respect to communications relating to the transaction. However, the privilege regarding pre-transaction business operations may not necessarily pass to a buyer in an asset sale where the buyer is not attempting to continue the pre-existing business operations. See *Tekni-Plex, 674* N.E.2d at 668.

These cases provide some guidance as to what attorneys should pay close attention when representing both the seller and a selling shareholder in the change in control of a company, as well as ways to avoid any major consequences. To some extent, the result may differ depending on how a transaction is structured and which state's law controls the entities and the transaction. Counsel should bear in mind the conflicting law in Delaware and New York, as well as the uncertainty as to how other state courts may handle the issue. In addition, it should be noted that it is not entirely clear whether an acquisition of a company through a stock acquisition would be treated more like a merger or an asset sale, but in the authors' opinion, it is more analogous to a merger.

Practitioners generally agree this new case law indicates a seller can preserve its rights to privilege by contract, but there is no guarantee. At a minimum, in order to avoid possible liability, an attorney should ensure at the outset of negotiations there is contractual language in the transaction agreement protecting transaction-related privileged communications. As noted in *Great Hill Equity Partners,* it is possible for the parties to include contract language explicitly excluding transaction-related communications and work product. 80 A.3d at 160. It may also be possible to exclude other pre-transaction communications, at least in the context of an asset sale, but it is less clear whether such exclusions will be permissible in the context of mergers or stock sales.

Regardless of the form of transaction, a merger or acquisition agreement should include provisions specifying which person or entity will retain the pre-transaction privilege and which types of communications are covered. If a seller wishes to retain control over the pre-transaction privilege, the provisions must clearly indicate what sorts of communications are covered by the privilege.

In addition to the steps listed above, the seller must take steps to ensure that any privileged information is protected, such as removing all privileged communications from company computers, ensuring all physical documents containing the privilege are segregated, and clearly informing the buyer that these documents will be withheld on the grounds that they contain privileged information. ■

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