

M&A Secrets Revealed?

Protecting a seller's attorney communications

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The attorney-client privilege is a bedrock principle of American jurisprudence whose purpose is to encourage clients to freely seek the aid of counsel with the confidence that the client's secrets and confidences will in fact remain secret and confidential. Without the protection of the attorney-client privilege, individuals and companies may be less likely to have the candid attorney discussions necessary to understand and comply with the law while achieving their business objectives.

This is especially true in the case of owners seeking to sell their companies. The sale of an owner's business is frequently the most important, complex, and stressful transaction the owner will ever face and involves the need to understand and seek guidance from counsel on a multitude of topics. These include disclosure and other seller obligations, deal terms and legal structures, potential liabilities, risk analysis and other issues. An owner will want to be able to share, without reservation, information and concerns with trusted counsel, free of the anxiety that confidential communications will be acquired and used by the buyer.

Transfer of the Privilege to the Buyer

Nevertheless, the M&A process often results in the disclosure of communications the owner thought were confidential to the buyer who succeeds to the assets and rights of the acquired business, including its books and records. As a result, the buyer can use such confidential information to its advantage in litigation against the owner in numerous ways, including accessing the information to develop case strategy, admitting the communications into evidence and disqualifying the counsel who previously represented the acquired business from representing the owner. This reality was exemplified last year by the decision of the Delaware Chancery Court in *Great Hill Equity Partners IV, LP v. AIF Growth Equity Fund I, LLLP*.

In *Great Hill*, then Chancellor Strine, a leading jurist who has since been appointed as Chief Justice of the Delaware Supreme Court, held that, in a merger transaction, the attorney-client privilege of the acquired company regarding negotiations over the merger passed to the acquiring corporation. The selling shareholders in *Great Hill* tried to argue, based in part on an earlier decision by the New York Court of Appeals in *Tekni-Plex, Inc. v. Meyner and Landis*, that pre-merger attorney-client communications regarding the merger negotiations did not pass to the surviving corporation on account of the importance of promoting the policies underlying the privilege, including encouraging full and frank communication between attorneys and their clients. The Court in *Great Hill* disagreed, in part on the basis of the express language of the Delaware merger statute, which provides that "all property, rights, privileges, powers and franchises" shall become effectually the property of the surviving corporation. The Court further emphasized that the seller could have negotiated in the merger agreement the retention of the privilege and had not taken any action for an entire year after closing to ensure the privilege remained in the selling shareholders' possession.

In California, the privilege can also easily pass to a buyer. This is particularly the case when the transaction is structured as a merger or stock sale. Under California Evidence Code Section 953, a successor to a merged corporation becomes the holder of the attorney-client privilege. Moreover, California Courts have long recognized that following a change in ownership of a company, the new ownership is free to use and waive the privilege of the acquired company. In at least one recent case (*Favila v. Katten Muchin Rosenman LLP*), however, the Court held that a sale of substantially all of the assets of a company did not result in the transfer of the attorney-client privilege.

Inapplicability or Waiver of the Privilege

Independent of the issue of whether the privilege passes to the buyer are the questions of whether the privilege applied in the first place, or, if it did apply, was it waived in the process. Just because a company hires an attorney as part of its deal team, this does not make all the communications with the attorney privileged. California Evidence Code Section 952 defines confidential information between a client and lawyer as:

"information transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those who are present to further the interest of the client in the consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted...."

In this context, consultation between a client and a lawyer over a lawyer's bargaining points on business terms with the other side, business-related documents that are shared with the lawyer, and drafts of contracts shared with third parties may not be privileged. The privilege may be waived if disclosures are provided broadly among members of the seller's deal team, which may include investment bankers, valuation experts, accountants, family members or others

whose involvement may be determined after the fact to not be necessary. Disclosure in a negotiation session to the other side of legal analysis for a particular position may also result in waiver of the privilege. There are also exceptions to the application of the privilege in cases of a joint representation of the selling company and its owners if there is a post-closing dispute between the selling company under new ownership and the former owners. Moreover, if a written document contains both privileged and non-privileged information, the owner may only be able to redact the portion which is privileged and may be required to disclose the rest.

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Apart from the legal challenges of establishing, maintaining and not waiving the privilege, there is the practical consideration that, almost always following a sale, the buyer will have physical possession of the selling company's books and records including emails and electronic data.

This is particularly important both as to what information a buyer may glean and also the *Great Hill* court's admonition as to the effect of an owner's failure to take reasonable steps to ensure the buyer did not have access to the privileged communications.

Takeaway Pointers

There are a number of takeaways sellers and their counsel should consider during the M&A process. These include:

- ▶ Initiating discussions at the beginning of the transaction process among the attorney, the client and other deal team members as to the limitations of the attorney-client privilege.
- ▶ Understanding how information is to be communicated between attorney and client, and issues involving the buyer's access post-closing to the selling company's email and electronic filing and retrieval systems.
- ▶ Educating the team on the need to avoid inadvertent and unnecessary copying or forwarding of emails and other documents to team members.
- ▶ Operating under a working assumption that all written communications could either not be subject to the privilege or may wind up in the hands of an adverse buyer.
- ▶ Segregating legal communications from business or non-legal communications.
- ▶ Being cognizant of issues arising from joint representation of the selling company and the owners, prior representation of the selling company on matters other than the business sale, or the structure of the transaction.
- ▶ Being careful of disclosure during negotiation sessions to the buyer of legal analysis or internal communications among the seller team.
- ▶ Particularly in the context of a stock sale or a merger, insisting on provisions in the definitive documents that vest the privilege as to sale negotiations in the selling owners post-closing, providing for the ability post-closing to access and retain in the owners' exclusive possession privileged documents, and addressing related issues, such as a conflict waiver by the target company in the event of a post-closing dispute.
- ▶ Taking actions post-closing to possess and control privileged documents.

Conclusion

To be sure, the treatment of attorney-client communications is but one of many items that sellers and their counsel will need to address as part of the sales process. Frequently, practical requirements in proceeding expeditiously to complete the transaction may impact the ability to adopt optimal procedures to protect and maintain the privilege. Just the same, it is important that clients and their attorneys discuss the issues surrounding the attorney-client privilege early on so that the client not discover for the first time in a post-closing dispute that the confidences the client thought to be secret are not so secret.

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