DELAWARE BUSINESS COURT INSIDER

December 11, 2013

An ALM Website

Pre-Closing Privileged Communications Pass to Surviving Corporation

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In *Great Hill Equity Partners IV v. SIG Growth Equity Fund I*, C.A. No. 7906-CS (Del. Ch. Nov. 15, 2013), the Delaware Court of Chancery held—in a matter of first impression—that pursuant to Section 259 of the Delaware General Corporation Law, the surviving corporation in a merger controls the seller entity's pre-closing privileged communications. The opinion has already sparked a fair amount of commentary, as practitioners consider the practical implications of the opinion's attention to a previously undiscussed aspect of Section 259: that the "privileges" a buyer acquires from a target company in a merger include attorney-client privilege over communications associated with the target.

Great Hill does not contain an extensive description of the background leading to the litigation, but what the court does provide is instructive. The underlying claim in the case involves a consortium of buyer entities led by Great Hill Equity Partners IV LP, a Delaware entity, that claims to have been fraudulently induced to acquire Plimus Inc., a California company. As a result of the merger, which closed approximately one year before the buyers filed suit, Plimus became a subsidiary of the buyers. The court indicated that the lawsuit was brought in the Chancery Court and Delaware law applied based on choice-of-law provisions set forth in the merger agreement.

The dispute over privileged communications arose when, during the course of the litigation, the buyers notified Plimus' former principals (the sellers) that they had discovered pre-merger communications about the merger negotiations between the sellers and Plimus' outside counsel on the computer system acquired through the transaction. The sellers claimed they had retained attorney-client privilege over the communications post-closing and that the communications could not be used by the buyers in the litigation, despite the fact that they had made no previous effort to retrieve the privileged communications or prevent their disclosure to the buyers as part of the merger. The buyers, on the other hand, argued that they had acquired the communications and Plimus' attorney-client privilege upon the closing of the merger, entitling them to use such information as part of their lawsuit against the sellers.

The issue was thus presented to the court in the context of a discovery dispute over the application of the attorney-client privilege. To support their argument, the sellers relied upon the New York Court of Appeals' decision in *Tekni-Plex v. Meyner & Landis*, 674 N.E.2d 663 (N.Y. 1996), which held that pre-closing privileged communications about merger negotiations—as opposed to privileged communications concerning general business matters that occurred before closing—do not pass to the surviving entity post-closing on policy grounds. But as corporate law commentators recognized, it "remain[ed] open whether Delaware courts would apply the *Tekni-Plex* exception or its equivalent under Delaware law," as Edward Welch and others wrote in "Mergers and Acquisitions Deal Litigation Under Delaware Corporation Law."

After remarking that the issue was one of statutory first impression under Delaware law, Chancery Court Chancellor Leo E. Strine Jr. distinguished *Tekni-Plex* on the ground that it did not involve Section 259. The court also similarly distinguished an earlier Chancery Court decision that had applied the Tekni-Plex exception in a case governed by New York law: *Postorivo v. AG Paintball Holdings*, Consol. C.A. No. 2991-VCP, slip op. at 9-13 (Del. Ch. Feb. 7, 2008).

Strine reasoned that if the Delaware Legislature had intended to exempt attorney-client privileged communications from the broad language of Section 259—which provides that, post-merger, "all property, rights [and] privileges" become the property of the surviving entity—the legislature would have done so. Strine found that the only reasonable interpretation of "all ... privileges" was a broad one that included attorney-client privilege, rejecting the seller's argument that the term "privileges" in Section 259 refers to property rights and does not extend to privileges extended by evidentiary rules. Strine also made the point that "there is a presumption that the [Delaware] General Assembly carefully chose particular language when writing a statute, and this court will not construe the statute to render that language mere surplusage if another interpretation is reasonably possible." He went on to explain that "whatever the case may be in other states, members of the Delaware judiciary have no authority to invent a judicially created exception to the plain words 'all ... privileges' and usurp the General Assembly's statutory authority."

For those concerned about the implications of the ruling, Strine offered a potential solution. "The answer to any parties worried about facing this predicament in the future is to use their contractual freedom ... to exclude from the transferred assets the attorney-client communications they wish to retain as their own." Without an express carve-out, all of the seller's pre-merger privileges, including those applying to merger negotiations, "pass ... to the surviving corporation in the merger, by plain operation of clear Delaware statutory law under §259 of the DGCL."

Strine's conclusion also appeared to be influenced by the seller's failure to address pre-merger privileged communications before the lawsuit was filed. The opinion specifically noted that the sellers had failed to: (1) negotiate a carve-out in the merger agreement for pre-merger privileged communications relating to the merger negotiations; (2) segregate or excise privileged communications concerning merger negotiations from the computer system before the merger closed; or (3) raise the issue with the buyers during the year between closing and when the buyers' lawsuit was filed.

Great Hill gives corporate advisers and deal-makers a number of factors to consider during merger negotiations. Following the court's comments about addressing post-closing ownership of privilege through contract, one can anticipate an emergence of such provisions in merger agreements (and perhaps other transaction agreements). As the court suggested, the agreement would need to clearly provide that the attorney-client privilege concerning merger negotiations does not transfer along with other "property, rights [and] privileges" to the surviving entity. It is also entirely possible that such provisions could be subject to future challenge, like any other contractual provision.

In light of the court's criticism of the Plimus sellers' pre-closing actions, parties engaged in deal negotiations should consider how they are organizing pre-merger privileged communications, and whether to take steps to segregate or excise such communications before closing. In addition, sellers should be mindful that pre-closing communications with counsel or about legal advice could potentially end up in the hands of the buyer after closing.

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