Court of Chancery Rules on Attorney-Client Privilege During Intra-Board and Post-Transaction Disputes

Contributors

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Two recent Delaware rulings have refused to compel disclosure of attorney-client privileged communications despite facially appealing arguments from the party seeking the materials. These decisions provide guidance to directors and target companies looking to preserve the integrity of attorney-client privileged communications.

Gilmore v. Turvo[1] provides guidance to directors facing complex circumstances involving differing director interests. The court was presented with a slight twist on the typical circumstances giving rise to board-level attorney-client privilege disputes — whether an excluded director was entitled to access communications between the other directors and counsel that took place while the plaintiff was still a member of the board. In *Gilmore*, the plaintiff was the co-founder, majority common stockholder, CEO and a director of Turvo, Inc. Turvo's board (the board) consisted of the plaintiff and three preferred stockholder designees (the preferred directors). As alleged (and denied by the plaintiff), in May 2019, Turvo's CFO discovered that the plaintiff had expensed "at least $125,000 in entertainment charges," including more than $76,000 to "adult entertainment venues." The CFO alerted one of the preferred directors, who sought the advice of law firm Latham & Watkins, rather than the board's longtime counsel. Latham previously had served as counsel for one of Turvo's preferred stockholders, but never had represented Turvo or the board. From May 10-21, 2019, Latham investigated and assessed the impact of the information on Turvo's business. Additionally, two of the preferred directors had their own personal attorneys advising them. On May 21, 2019, the directors convened a meeting to discuss the plaintiff's alleged misconduct and then asked plaintiff to recuse himself. Thereafter, the preferred directors purported to remove the plaintiff as CEO and to adopt a resolution retaining Latham "as counsel for the Board 'effective as of May 10, 2019.'"[2] According to Turvo, "the resolution's retroactive language was meant to allow Turvo to pay the legal fees incurred by the Preferred Directors prior to the May 21 meeting."

In the ensuing litigation, the plaintiff argued that he was entitled to receive privileged communications between Latham and the preferred directors from May 10-21, 2019, because he was a board member during that time, and Latham had "functionally served as counsel to the Board by advising the Preferred Directors." The Court of Chancery disagreed. While acknowledging the general rule providing directors full access to privileged communications between the board and its counsel, the court concluded that the communications between Latham and the preferred directors were not communications "furnished to the board" and that the plaintiff had failed to show that he "had a reasonable expectation that the attorney(s) in question were representing all members of the board." The court noted that there was "no act by the Board to hire Latham as Board counsel prior to the May 21 meeting" nor "any indication that Latham had agreed to represent the Board prior to that meeting." The court rejected "[o]ffhand comments" made by a preferred director after removing the plaintiff as CEO, in which he stated that "[t]he board" worked continuously to "fix" the situation. The court also rejected the plaintiff's argument that the resolution to backdate Latham's representation to May 10, 2019 provided a basis to conclude that Latham served as the board's counsel prior to May 21, 2019. The court found that the board "was entirely within its business judgment to determine that the company should pay the Preferred Directors' fees by deeming Latham to have been working on behalf of the company prior to May 21." The court noted that Latham's preexisting relationship with a Turvo preferred stockholder gave it

[1] 2019 WL 3937606, at *1 (Del. Ch. Aug. 19, 2019).

[2] The Turvo board would formally establish a special committee on May 23, 2019. The court, however, offers no discussion about the establishment of a special committee prior to May 21, 2019.

"some comfort that the Preferred Directors did not set out to establish a backdoor to hiring Latham as Board counsel while shielding their communications from Mr. Gilmore." Accordingly, the court refused to compel Turvo to turn over the privileged communications.

In *Shareholder Representative Services LLC v. RSI Holdco, LLC*,[3] the court refused a buyer's request to compel the seller to turn over all of its preclosing privileged communications because the seller expressly contracted to maintain the privilege. In 2016, RSI Holdco, LLC acquired Radixx Solutions International, Inc. As part of the acquisition, RSI Holdco obtained possession of Radixx's computers and email servers, which contained approximately 1,200 pre-merger emails between Radixx and its counsel. During post-closing litigation, RSI Holdco requested access to the emails, arguing that the attorney-client privilege had been waived by the target because Radixx took no steps to "excise" or "segregate" the privileged communications from the computers and email servers before transferring them to the buyer.

The court found that Radixx had not waived privilege. In deciding the dispute, the court looked at *Great Hill Equity Partners IV, LP v. SIG Growth Equity Funds I, LLP*,[4] which provided guidance for drafting continued privilege protections. There, the court found that privilege was waived when pre-merger privileged communications between the target and its counsel were transferred to the surviving company because the target took no affirmative steps to prevent the transfer or preserve the privilege. The court advised that, in the future, sellers should "use their contractual freedom" to "exclude from the transferred assets the attorney-client communications they wish to retain as their own" and, thus, avoid waiver.

By contrast, in *RSI Holdco*, Radixx contracted in "plain and broad language" to preserve its ability to assert privilege over pre-merger attorney-client communications. The merger agreement also (i) contained a "no-use" clause preventing the buyer from using or relying on those privileged communications in post-closing litigation against the target; (ii) expressly assigned control over the privilege to a third party, Shareholder Representative Services; and (iii) required both the seller and the buyer to take "steps necessary to ensure that the privileges remain in effect." Together, these provisions prevented the buyer from using the privileged communications in post-closing litigation with the seller and, notably, did not require the seller to take additional steps to "excise" or "segregate" the privileged communications from the computers and email servers before transferring them to the buyer.

As *Gilmore* and *RSI Holdco* demonstrate, directors seeking to comply with their fiduciary duties in the face of potentially conflicting interests among board members, as well as directors negotiating intricate transactions, face a complex and nuanced question regarding the privilege of any advice they receive. Preserving the attorney-client privilege is possible, but can require careful analysis and planning. Directors should consult counsel on the best path forward to protect the company, its stockholders and its directors.

[3] 2019 WL 2290916, at *1 (Del. Ch. May 29, 2019) (RSI Holdco).

[4] 80 A.3d 155 (Del. Ch. 2013).