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Who Can Assert The Attorney-Client Privilege After A Corporation Is Sold – The Seller or The Buyer?

by, Peter J. Gallagher

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Imagine you are a representative of Company A when a group of investors contacts you to propose a merger. On behalf of Company A, you consult with Company A's outside counsel about the terms of the deal. Eventually, the deal goes through and Company A is the surviving corporation following the merger. Unfortunately, the merger does not go as planned, and the new owners of Company A (the "Buyers") sue, alleging that you and some of your fellow, now former, representatives of Company A (the "Sellers") fraudulently induced Buyers into purchasing the company. During discovery, Buyers produce communications you and others had with Company A's outside counsel during the merger negotiations, which were found on the computers Buyers acquired as part of the merger. Are you allowed to assert the attorney-client privilege in connection with these communications?

Although it sounds like a hypothetical from a law school ethics exam, this actually happened recently, and the answer to the question, at least according to the Delaware Chancery Court, was "no." In Great Hill Equity Partnership IV, L.P. v. SIG Growth Equity Fund I, LLP, 80 A.3d 155 (Del. Ch. 2013), the Court held that, under Delaware law, unless the parties agree to a different arrangement, all privileges are transferred to the surviving entity, including the attorney-client privilege, following a merger. Accordingly, Sellers in that case had no right to assert the privilege in connection with their communications with the company's outside counsel prior to the merger. The lesson to be learned from this case is that, if you want to protect communications like these from discovery under the attorney-client privilege, you must include a provision in the merger documents making this intention clear.

The issue before the Court in Great Hill was one of statutory interpretation. Under Section 259 of the Delaware General Corporation Law, following a merger, "all property, rights privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation . . . . " The Court held that "all privileges" means "all privileges" and rejected Sellers' claim that the attorney-client privilege should be excluded from the statute. The Court noted that Sellers cited to no authority in the statute, its legislative history, or any case law in support of their argument.

As part of its decision, the Court was sharply critical of a decision by the New York Court of Appeals, which held that pre-merger attorney-client communications do not pass to the surviving corporation under Delaware law. The Court noted that the New York Court of Appeals created this exception without explaining the obvious inconsistency with the otherwise broad "all privileges" language of Section 259. Rather, the Court held that, had the Delaware legislature intended the exception that the New York court read into Section 259, it would have included it in the text of Section 259. Because it did not, the Court was unwilling to engage in what Buyers called "judicial improvisation," and read such an exception into Section 259. In what appeared to be a thinly-veiled jab at the New York Court of Appeals, the Court concluded: "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 [legislature's] statutory authority."

Finally, the Court noted that if Sellers had intended to retain the attorney-client privilege in connection with pre-merger negotiations, they should have included a provision doing just that in the merger agreement. Because they did not, the attorney-client privilege passed to Buyers along with all other privileges formerly held by Sellers.
Because the Court held that the attorney-client privilege passed as a matter of law to Buyers, it did not address whether, had this not been the case, Sellers would have nonetheless waived the attorney-client privilege by failing to take any steps to ensure that Buyers did not have access to the pre-merger communications. However, the Court characterized this as a "substantial issue," which suggests that it was skeptical of Sellers' ability to assert the privilege in light of the fact that: the allegedly privileged communications were found on computers that Buyers acquired from Sellers; Sellers apparently did nothing to prevent Buyers from accessing the documents; and Sellers never asked that the documents be returned in the year between the merger and the lawsuit.

Ultimately, the lesson to be learned from Great Hill is that if you are a representative of a corporation that is being acquired or entering into merger negotiations, and there are any concerns about protecting the corporation's pre-merger communications with counsel, make sure that this protection is built into the merger or sale agreement. If not, and if the dispute is governed by Delaware corporate law, the privilege will be passed to the surviving corporation as a matter of law.

Peter Gallagher focuses his practice at Porzio Bromberg & Newman P.C. on general commercial litigation, while also representing the firm's real estate clients in matters involving commercial lease litigation, real estate contract disputes, prerogative writs, and zoning appeals. Pete has represented clients at the trial and appellate levels in state and federal courts in New York and New Jersey. He is an accomplished litigator, and counsels clients on issues in effort to mitigate potential problems before they become the subject of litigation.

As an avid writer, Pete has authored articles for publications ranging from the NJ Law Journal to journals at the Georgetown University Law Center and the Seton University Law School. He is also the editor and one of the primary bloggers on Porzio real estate blog, Porzio Real Property Blog.

In addition, Pete has been an adjunct professor of Legal Research and Writing at the Seton Hall University School of Law and was nominated for Adjunct Professor of the year 2011.