

ASSIGNING OWNERSHIP OF PRIVILEGE IN M&A DEALS & ETHICS IN FOLLOW-ON DISPUTES

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KEY CASE LAW

01

Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP

80 A.3d 155 (Del. Ch. 2013)

Facts

- Buyer merged with Seller, and later sued Seller for fraud
- Buyer obtained Seller's computers, which contained privileged communications
- Merger agreement did **not** carve out Seller's privilege from assets transferred to Buyer

Holding

- Seller's privilege passed to Buyer as a matter of law

Rationale

- Delaware merger statute (§ 259 of the DGCL) says "all property, rights, privileges, powers and franchises, and all and every other interest shall be ... the property of the surviving or resulting corporation"
- The plain terms of the statute required the outcome
- Court noted parties can **contract around** this default rule

Shareholder Representative Servs. LLC v. RSI Holdco, 2019 WL 2290916 (Del. Ch. May 29, 2019)

Facts

- Buyer merged with Seller, and Seller later sued for breach of the merger agreement
- Merger agreement **did** carve out Seller's privilege from assets transferred to Buyer
- Buyer obtained Seller's computers, which contained privileged communications
- Buyer argued Seller waived privilege and wanted to use the emails in the litigation

Holding

- Privilege remained with Seller, and Seller did not waive privilege

Rationale

- Merger agreement carve out + "no use" provision defeated Buyer's argument
- Court rejected argument that Seller waived privilege by failing to remove the privileged communications from the computers before giving them to the Buyer

DLO Enterprises, Inc. v. Innovative Chem. Prods. Grp., LLC, 2020 WL 2844497 (Del. Ch. June 1, 2020)

Facts

- Buyer purchased assets of Seller
- Seller and Buyer disputed who bore liability for certain products
- Buyer obtained Seller's email accounts, which contained privileged emails

Holding

- "In the asset purchase context, the **seller will retain pre-closing privilege** ... unless the buyer clearly bargains for waiver."

Rationale

- The law distinguishes between mergers and asset purchases:

"Mergers governed by statute, which automatically transfer 'all property, rights, privileges, powers and franchises,' are distinct from **asset purchase transactions** governed by agreements, which **enumerate the assets being sold.**"

"**The seller still exists**, holding any assets that were not purchased, together with related privileges."

KEY LANGUAGE IN TRANSACTION AGREEMENTS

02

Transaction Structures

Asset Transaction

- Privilege is an asset and remains with the seller unless specifically bargained for as part of the transaction

Merger Transaction or Stock Transaction

- Typically, the target company is the party engaging counsel in a transaction
- Privilege is an asset of the target company and transfers as a matter of law ***unless*** the parties to the transaction contract around this rule

Operative Language in Transaction Agreement

What is the scope of the communications that should be subject to the retained privilege?

- All communications with counsel occurring pre-closing
- Only communications directly related to the transaction
- Everything in between (i.e., communications not related to the transaction at first that later become part of the transaction)

Who *owns* the target company privilege?

- Stockholder group and/or the Stockholder Representative
- Buyer
- Surviving Corporation (in a merger)

Who *controls* the target company privilege?

- Stockholder group and/or the Stockholder Representative
- Buyer
- Surviving Corporation (in a merger)

Sample Language

Only the Stockholders, the Company and their respective Affiliates shall be considered clients of Stockholders/Company Acquisition Counsel in the Acquisition Engagement. Acquiror, on behalf of itself and its Affiliates (including, after the Closing, the Surviving Corporation) acknowledges and agrees that ***all confidential communications between the Stockholders, the Company and their respective Affiliates, on the one hand, and Stockholders/Company Acquisition Counsel, on the other hand, in the course of the Acquisition Engagement, and any attendant attorney-client privilege, attorney work product protection, and expectation of client confidentiality applicable thereto (“Deal Communications”), shall be deemed to belong solely to the Stockholders and their respective Affiliates (other than the Company), and not the Company, and shall not pass to or be claimed, held, or used by Acquiror or the Company (or, after the Closing, the Surviving Corporation) upon or after the Closing.***

Operative Language in Transaction Agreement

Who has access to the privileged communications?

- Stockholders
- Stockholder Representative
- Buyer
- Surviving Corporation (in a merger)

Buyer's ability to assert target company privilege against third parties

Buyer's ability to waive target company privilege against third parties

- Consent requirement

Sample Language

Accordingly, whether or not the Closing occurs, Acquiror ***shall not have access*** to any Deal Communications, or to the files of Stockholders/Company Acquisition Counsel relating to the Acquisition Engagement, or ***have any right to discover or obtain any information or documentation relating to the Acquisition Engagement that is subject to an attorney-client privilege, work product protection or other expectation of confidentiality owed to a Stockholder and/or its Affiliates.***

Without limiting the generality of the foregoing, upon and after the Closing, (i) to the extent that files of Stockholders/Company Acquisition Counsel in respect of the Acquisition Engagement constitute property of the client, ***only the Stockholders and their respective Affiliates shall hold such property rights*** and (ii) Stockholders/Company Acquisition Counsel ***shall have no duty whatsoever to reveal or disclose any such attorney-client communications or files to the Company*** (or, after the Closing, the Surviving Corporation) ***or Acquiror*** by reason of any attorney-client relationship between Stockholders/Company Acquisition Counsel and the Company or otherwise; provided, however, that notwithstanding the foregoing, Stockholders/Company Acquisition Counsel shall not disclose any such attorney-client communications or files to any third parties (other than Representatives, accountants and advisors of the Stockholders and their respective Affiliates; provided that such Representatives, accountants and advisors are instructed to maintain the confidence of such attorney-client communications).

Sample Language Continued

If and to the extent that, at any time subsequent to Closing, Acquiror or any of its Affiliates (including, after the Closing, the Surviving Corporation) shall have the right to assert or waive any attorney-client privilege with respect to any communication between the Company or its Affiliates and any Person representing them that occurred at any time prior to the Closing, ***Acquiror, on behalf of itself and its Affiliates (including, after the Closing, the Surviving Corporation) shall be entitled to assert or waive such privilege only with the prior written consent of the Stockholders (such consent not to be unreasonably withheld).***

Operative Language in Transaction Agreement

- Buyer's ability to disclose privileged communications if legally required
- Buyer's ability to request privileged communications
- Savings clause

Sample Language

If Acquiror is required by any legal proceeding or government authority to disclose any Deal Communications notwithstanding anything herein to the contrary, ***Acquiror shall promptly notify the Stockholders (if legally permissible) prior to furnishing such information***, and will seek reasonable arrangements to protect the Deal Communications to the maximum extent possible and only disclose that information necessary to comply with such legal proceeding or government authority.

All files, attorney notes, drafts or other documents in the Company Acquisition Counsel's possession that are Deal Communications ***shall be the property of the Stockholders, and the Company Acquisition Counsel shall have no duty, and Acquiror may not request Company Acquisition Counsel, to disclose any Deal Communications to Acquiror or any of its affiliates.***

Acquiror hereby ***agrees not to search for or use any Deal Communications existing on the Surviving Corporation's electronic backup systems, e-mail archives or other books and records after the Closing***, the existence of any Deal Communications in the Surviving Corporation's possession after the Closing ***shall not be deemed a waiver of the privilege related to such Deal Communications***, and the parties agree to ***take all reasonable steps necessary to ensure such privilege shall survive the Closing.***

KEY LITIGATION & ETHICAL DUTIES

03

Litigation After Closing & the Ethical Duties

Let's assume:

- Purchase agreement assigns the privilege to the seller
- The privileged communications remain on the company's servers (now owned by the buyer) and have not been segregated in any way
- A third party has sued the company and seller's privileged communications are potentially relevant

Ethical Duties Under California Law

The *State Fund* Rule:

- When a lawyer who receives materials that obviously appear to be subject to an attorney-client privilege or otherwise clearly appear to be confidential and privileged and where it is reasonably apparent that the materials were provided or made available through inadvertence, **the lawyer receiving such materials should refrain from examining the materials any more than is essential to ascertain if the materials are privileged, and shall immediately notify the sender that he or she possesses material that appears to be privileged.** The parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified.

State Compensation Insurance Fund v. WPS Inc., 70 Cal. App. 4th 644, 656-57(1999).

Ethical Duties Under California Law Continued

Unlike federal rules, *State Fund* duties apply outside of discovery.

California courts applying *State Fund* have explicitly held that materials will be deemed as provided through “inadvertence” when the privilege holder did not intend to disclose them, and unlike the Federal Rules, an attorney's *State Fund* duties are not limited to documents produced through discovery.

- *Doe v. Fitzgerald*, No. CV2010713MWFRAOX, 2022 WL 4596557, at *6 (C.D. Cal. Sept. 21, 2022).

Compare with FRCP 26(b)(5)(B):

- If information *produced in discovery* is subject to a claim of privilege or of protection as trial-preparation material, the party making the claim may notify any party that received the information of the claim and the basis for it. After being notified, a party must promptly return, sequester, or destroy the specified information and any copies it has

Ethical Duties Under California Law Continued

Will California honor the privilege assignment under Delaware law?

- California has “strong policy considerations favoring the enforcement of freely negotiated choice-of-law clauses.” *Kaul v. Mentor Graphics Corp.*, 2016 WL 6249024, at *6 (N.D. Cal. Oct. 26, 2016), aff’d 730 F. App’x 437 (9th Cir. 2018).
- One federal court—*Sentinel Offender Servs., LLC v. G4S Secure Sols., Inc.*, No. SACV14298JLSJPRX, 2015 WL 13546228 (C.D. Cal. Sept. 3, 2015) — has followed *Great Hill* and enforced a contractual provision assigning privilege to the seller. *Id.* at *2-3.
- It did so even though it recognized that in California, “when one company acquires or takes control of another, attorney-client privilege passes to the purchaser.” *Id.* at *2.

Ethical Duties Under California Law Continued

So what do you do?

- Segregate
 - But who does it?
- Inform appropriate person on seller side
 - Who is that?
- Review
 - But who does it?
- Assert the privilege
 - But who does it?

Limits on the Assignment

***Hyde Park Venture Partners Fund III, L.P. v. FairXchange, LLC*, 292 A.3d 178, 183 (Del. Ch. 2023)**

Facts

- Startup company received an offer to buy it
- 2 of the 3 directors were in favor; 1 director, who was appointed by a venture capital firm with a significant investment in the company opposed
- Venture capital firm sued and demanded production of privileged materials from the time that the dissenting director was on the board

Holding

- The assignment of the privilege to the seller was irrelevant to the privilege question

Rationale

- The dissenting objector's company had a right to the privileged materials because the dissenting objector had a right to them at the time under Delaware law
- The assignment of the privilege doesn't change the situation

Practical Tips for Managing Privileged Communications

- Consider segregating pre-closing deal-related communications (effectively creating a pre-closing wall)
 - At the outset of the transaction
 - At the closing or near the closing of the transaction
- Consider discussing post-closing use of pre-closing deal-related communications with employees continuing with the surviving corporation (i.e., a continuing general counsel)
- If there are multiple selling stockholders, but no stockholder representative is designated under the purchase agreement, consider appointing one stockholder (or a third party) to serve as the stockholder representative for privilege related issues that may arise post-closing

A low-angle, upward-looking shot of a modern skyscraper with a glass facade. The building's structure is composed of a grid of dark metal frames holding large glass panels. The sky is visible through the upper part of the frame. The text "GIBSON DUNN" is centered in white, bold, sans-serif capital letters. In the lower right, a person's silhouette is visible through one of the glass panels, appearing to be working at a desk or looking at a screen.

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