AN A.S. PRATT PUBLICATION
NOVEMBER-DECEMBER 2024
VOL. 10 NO. 9

PRATT'S PRIVACY & CYBERSECURITY LAW REPORT

LexisNexis

Pratt's Privacy & Cybersecurity Law Report

VOLUME 10 **NUMBER 9** **November-December 2024**

LexisNexis®

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ISBN: 978-1-6328-3362-4 (print)
ISBN: 978-1-6328-3363-1 (eBook)

ISSN: 2380-4785 (Print)
ISSN: 2380-4823 (Online)

Cite this publication as:
[author name], [*article title*], [vol. no.] PRATT'S PRIVACY &CYBERSECURITY LAW REPORT [page number] (LexisNexis A.S. Pratt);
Laura Clark Fey and Jeff Johnson, *Shielding Personal Information in eDiscovery*, [7] PRATT'S PRIVACY & CYBERSECURITY LAW REPORT [179] (LexisNexis A.S. Pratt)

An A.S. Pratt Publication
Editorial

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(2024–Pub. 4939)

Editor-in-Chief, Editor & Board of Editors

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Control of Privileged Deal Communications in Post-Closing M&A Disputes

By Jacob Alderdice, Billy Goldstein and Elizabeth Avunjian*

When M&A deals close, buyers often come into possession of sellers' pre-closing attorney-client communications. In the event of a post-closing dispute, this scenario raises several thorny issues. This article discusses those issues and considers how best to manage them.

After a merger or acquisition has closed, disputes may arise between the buyers and the target company's sellers that lead to litigation. These litigations often present a difficult issue of attorney-client privilege: at closing, the buyers frequently come into possession of the sellers' pre-closing attorney-client communications. This happens because, during negotiations and in the leadup to execution and closing, each side usually consults by email with its own deal counsel about the transaction. When the deal closes, the target company's assets will transfer to the buyer. Those assets often include email servers, which typically contain the sellers' deal-related emails with their counsel.

This common scenario raises a host of thorny issues. In a post-closing dispute between buyer and sellers, who controls these communications? Can the buyer use them in the dispute? If not, what should buyer's counsel do with these communications to avoid violating the sellers' attorney-client privilege? How should they be handled during the discovery process? These questions can profoundly impact legal strategies, and the parties' access to sensitive information, in post-closing M&A disputes. Answering them correctly requires both careful attention to the terms of the merger agreement and the law governing the transaction, and a thoughtful plan for navigating practical issues that arise in discovery.

THRESHOLD ISSUE: WHAT DOES THE CONTRACT SAY?

The critical first inquiry is what if anything the merger agreement or other transaction documents say about control of the sellers' privileged pre-closing deal communications. Increasingly, merger agreements do speak directly to this issue. In one analysis, approximately two-thirds of recent merger agreements had a provision assigning control of the privilege.[1] Of those, the majority assign control to the sellers or sell-side affiliates.[2]

While these contract provisions vary considerably, they often accomplish some or all of the following goals:

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[1] See SRS Acquiom Insights, What to Make of the Great Hill Case – The M&A Bar is Not Yet in Agreement on How Best to Address Merger Agreement Privilege Issues, at 2 (Jan. 2021 Update).

[2] Id.

(1) Distinguishing privileged pre-closing deal communications on the target company's email servers from other communications on those servers even after they come into the buyer's possession;

(2) Assigning control or ownership of the privilege to the sellers or their representatives;

(3) Requiring the buyer to take affirmative steps to assert and maintain the sellers' privilege as against third parties, in order to avoid a waiver; and

(4) Restricting what the buyer can do with the communications, e.g. prohibiting access or use of them against the sellers.

IS THE CONTRACT'S PRIVILEGE PROVISION ENFORCEABLE? PROBABLY.

Buyers sometimes argue that, notwithstanding a seller-protective contract provision governing the pre-closing deal privilege, the sellers have waived the privilege through inaction. For example, if the sellers fail to segregate their privileged deal communications before the transaction closes, the buyer may argue that it should be allowed to use the sellers' privileged deal communication regardless of the contract.

Courts have not been sympathetic to these "waiver-by-inaction" arguments. So while every fact pattern must be assessed on its own terms, in general, if the merger agreement contains an applicable provision on the pre-closing representation privilege, it will likely control, and the sellers can rely on the clear and express terms of the contract without more.

For example, in *Shareholder Representative Services LLC v. RSI Holdco, LLC*, the Delaware Court of Chancery enforced a merger agreement provision prohibiting the buyer from making use of the sellers' pre-closing privileged deal communications.[3] The buyer had argued that the sellers waived the privilege by failing to take steps to excise or segregate their privileged communications from the target company's email servers before the buyer acquired them. The court rejected this argument, holding that the merger agreement "prevents [Buyer] from doing exactly what [Buyer] seeks to do – use the Emails in litigation with the sellers."[4]

RSI Holdco underscores the power of seller-friendly contract provisions to protect sensitive seller information, even when that information is in the buyer's possession and the sellers have taken no other steps to protect it.

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[3] Shareholder Representative Services LLC v. RSI Holdco, 2019 Del. Ch. LEXIS 196, (Del. Ch., May 29, 2019).

[4] Id., 2019 Del. Ch. LEXIS 196 at *8.

WHERE THE CONTRACT IS SILENT, DEFAULT RULES ABOUND

If the merger agreement does not assign control of the sellers' pre-closing privileged deal communications, then control will usually be determined by background legal rules. These default rules for assigning control of the pre-closing privilege vary by both jurisdiction and transaction structure. Where the contract is silent, it is thus critically important to determine the default rules applicable to the transaction. Some illustrative examples follow.

Mergers Under New York vs. Delaware Law

Under the New York Court of Appeals' decision in *Tekni-Plex, Inc. v. Meyner & Landis*, New York's default rule is that sellers retain control of the privilege over their pre-closing deal communications with the target company's attorneys, while control of the privilege over the target's "general business communications" passes to the buyer.[5]

By contrast, under Delaware law, *all privileges* pass to the buyer at closing by default, as set forth in the seminal *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP* decision.[6] In *Great Hill*, the Delaware Court of Chancery applied Section 259 of the Delaware General Corporation Law, which provides that following a merger, "all [of the target company's] property, rights, [and] *privileges* . . . shall be thereafter as effectually the property of the surviving or resulting corporation. . . ."[7] The Chancery Court criticized the New York Court of Appeals' contrary decision in *Tekni Plex*, stating that the Court of Appeals had "innovated and, without citing § 259 of the DGCL, concluded that [the privilege over deal emails] did not pass to the surviving corporation for policy reasons related to its analysis of New York attorney-client privilege law."[8] Recognizing the policy concerns arising from a strict application of Section 259, the Delaware Chancery Court observed: "[P]arties in commerce can – and have – negotiated special contractual agreements to protect themselves and prevent certain aspects of the privilege from transferring. . . ."[9] In other words, merger parties can contract around the default rules – as most of them now do.

Mergers vs. Asset Purchase Agreements

Default rules can also vary by the structure of the transaction. For example, while under Delaware law all privileges pass to a *merger* buyer by default, the result is different for asset purchase agreements. When the transaction is structured as an asset purchase

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[5] See 674 N.E.2d 663, 670-72 (N.Y. 1996).

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

[7] Id. at 156 (quoting 8 Del. C. § 259) (emphasis added).

[8] Id. at 158.

[9] Id. at 160.

agreement, control of the sellers' pre-closing privileged deal communications *does not* pass to the buyer unless "the buyer clearly bargains for waiver or a waiver right" in the transaction documents.[10] Delaware courts have reached this result on the ground that "[u]nlike a merger, in an asset purchase transaction the selling entity is not extinguished" and as such, they "must look to the Purchase Agreement, not a statute."[11]

Choice of Law

Determining what law applies to a deal is not always straightforward. In complicated transactions with multiple agreements that are governed by different law and parties spread out in different forums, the answer can depend on a court's choice of law analysis. The New York Appellate Division, Second Department's decision in *Askari v. McDermott, Will & Emery, LLP* is illustrative.[12] The parties there were fighting over control of the sellers' counsel's pre-closing deal communications. Some of the transaction documents were governed by New York law; others had Delaware forum selection clauses; all of them were silent on control of the pre-closing privilege. The dispositive issue was whether New York or Delaware law applied – i.e., whether the decision was governed by *Tekni-Plex* or *Great Hill*. The Appellate Division reasoned that because the privileged communications at issue were made in New York between New York-based attorneys and a New York corporation that was majority owned by a New York resident, New York's choice of law principles required application of New York law – and victory for the sellers.[13]

The *Askari* decision illustrates the complexity that can arise when transaction documents are silent about control of the sellers' pre-closing privilege and the outsize role the forum can play in determining that control.

PRACTICAL CONSIDERATIONS IN DISCOVERY

Often, buyer's counsel will need to process the sellers' privileged deal communications through discovery – and do so without impinging on the sellers' privilege. This can be a fraught process that requires careful planning. Two issues in particular may be vexing: (1) identifying potentially seller-privileged emails; and (2) determining who reviews those documents. Both issues are more manageable if buyer and sellers' counsel can work together collaboratively.

Search terms and metadata can be used to identify potentially seller-privileged documents in the buyer's custody without actually looking at them. However, buyer's counsel will typically have insufficient information to generate an appropriate set of search parameters and will need input from sellers' counsel. Even if buyer's counsel

[10] See DLO Enterprises, Inc. v. Innovative Chem. Prod. Grp., LLC, 2020 Del. Ch. LEXIS 202, at *11 (Del. Ch. 2020).

[11] Id., 2020 Del. Ch. LEXIS 202, at *9.

[12] See 114 N.Y.S.3d 412 (N.Y. App. Div. 2019).

[13] Id. at 432-33.

does have sufficient information, getting buy-in and agreement from sellers' counsel on the search parameters will often be desirable. While the court can resolve disputes over search terms, disputes over privilege can be particularly burdensome and bog the parties down when they are trying to get the discovery process off the ground.

Any set of search parameters will be both under- and over-inclusive: it will not capture all potentially seller-privileged documents, and it will capture documents that should remain with the buyer, including potentially buyer-privileged documents.[14] Depending on the level of trust between the parties and counsel, this under- and over-inclusiveness can impact who reviews potentially seller-privileged documents in discovery.

Of course, the sellers cannot allow the main case team for their litigation adversary, the buyer, to review their potentially privileged documents. That leaves two primary options.

First, the review could be conducted by the main case team for sellers' counsel. Sellers' counsel will then have the responsibility to produce or log their own documents as appropriate, and to return to buyer's counsel any buyer-privileged documents they encounter. This is a potentially cost-effective and efficient option, as the review is likely to be performed by reviewers who are familiar with the facts of the case. But it does risk exposing sellers' counsel to buyer-privileged information, and requires a degree of trust between buyer's and seller's counsel.

Second, the review could be conducted by a clean team. Clean teams can be composed of outside contractors, or of attorneys from the law firms representing buyer, sellers, or both, who are screened from the primary case teams. The downside to clean teams is that they are more complicated and costly, as they entail an additional layer of privilege review by reviewers who are less familiar with the facts. The potential advantage of clean teams is that they create less risk of exposing primary case teams to the other side's privileged information. But this advantage can be hard to achieve in practice, in part because of the clean team's unfamiliarity with the facts. The clean-team approach may be more attractive where there is little trust between the parties.

Thus, it is incumbent upon counsel for buyers and sellers not only to think through the murky legal issues surrounding the sellers' pre-closing deal communications, but to proactively address the logistics and costs involved when such documents become part of discovery.

CONCLUSION

Post-closing M&A disputes often present a thorny privilege issue: the sellers' privileged pre-closing deal communications are in the buyer's possession. Who

[14] The search parameters may capture buyer-privileged documents because privileged pre-closing communications between the target company and sellers and their attorneys that are not about the transaction are generally the property of, and freely accessible to, the buyer.

controls these communications is often governed by the transaction documents, which courts typically enforce as written. Where the contract is silent, background legal rules determine who controls the privilege. Differences in these default legal rules across jurisdictions and transaction structures can lead to wildly different outcomes on otherwise similar facts, and require careful analysis from counsel. When buyer's counsel must process potentially seller-privileged documents through discovery, difficult issues can arise around the identification and review of such documents. These issues can be managed through careful planning and, ideally, cordial collaboration among opposing parties.