Protecting Attorney–Client Privilege for Pre-Merger Communications

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Authors' Note

Readers' comments and feedback on this series of "Whoops—Legal Malpractice Prevention" articles are welcomed and appreciated. References in the articles to "safest courses to proceed," "safest course," or "best practices" are not intended to suggest that the Colorado Rules require such actions. Often, best practices and safest courses involve more than just complying with the Rules. In practice, compliance with the Rules can and should avoid a finding of discipline in response to a grievance or a finding of liability in response to a malpractice claim. However, because most claims and grievances are meritless, effective risk management in the modern law practice involves much more. Hence, best practices and safer courses of action do more: they help prevent and more quickly defeat meritless claims and grievances.

Both clients and attorneys expect the attorney–client privilege to protect all privileged communications between the client and the attorney, regardless of whether the client is a corporation or an individual.[1] Corporate clients involved in heavily negotiated deals for mergers and acquisitions expect the privilege to protect communications between the attorney and the company's directors, officers, and other high-level executives. However, such transactions present the risk of unintentional disclosure of privileged communications, because it is often difficult to determine which entity owns the attorney–client privilege following the merger or acquisition.

This article discusses who owns the attorney–client privilege after a corporate merger or acquisition, reviewing the law in both Colorado and other jurisdictions. The article concludes with best practices to protect both the attorney and his or her client's attorney–client privilege in mergers and acquisitions.

Who Owns the Attorney–Client Privilege for Pre-Merger Client Communications?

Consider an attorney who represents a corporate client in negotiating the sale of its business to a competitor. When the sale closes, the client company's assets are a part of the competitor's business. But who owns the privilege related to the client's communications with counsel predating the merger? If the competitor now owns the client's assets, does the competitor also own the client's privilege?

The answer is not always clear. And the implications for clients, and for attorneys who fail to inform their clients of those implications, can be serious. One notable case in Delaware, which is the preferred jurisdiction for many corporate entities,[2] illustrates this challenge.

The underlying dispute in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*[3] arose between parties to a

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merger transaction that involved the acquisition of a software company. In *Great Hill*, a full year after the merger, the buyers filed suit alleging that defendants, former shareholders and representatives of the acquired corporation to the merger (seller), had fraudulently induced buyers to acquire the software company. Buyers based their claims largely on pre-merger communications between seller and its counsel regarding the transaction. Buyers found these communications on the software company's computer system. When seller learned that buyers had obtained these communications, it argued that its pre-merger privilege survived the merger. Buyers responded that the attorney–client privilege was simply an asset purchased from seller.[4]

The court agreed with buyers and held that the attorney–client privilege passed to them in the merger.[5] The court relied on a Delaware statute providing that "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 as they were of the several and respective constituent corporations."[6] As a result, the successor corporation had the right to all pre-merger communications between the acquired corporation and its attorneys, even though that company had been on the opposite side of the deal at the time.

This outcome in *Great Hill* is not a new risk for corporate attorneys. This issue has become common in the bankruptcy context[7] and in cases involving the FDIC acting as successor to banks.[8] Routinely, successors-in-interest, such as trustees and receivers, have been vested by operation of law with the rights of the corporation to waive the privilege or to learn the content of otherwise protected communications.

Great Hill is different from situations involving successors-in-interest because the acquiring corporation and the acquired entity were adversaries in the merger transaction. Having been on opposite sides of the deal, each with its own counsel, the respective clients almost certainly had an expectation that the attorney–client privilege would protect its strategies, goals, and purposes, subject only to the known exceptions. Bur those exceptions, such as the crime-fraud exception, were not dispositive in the case. Instead, *Great Hill* turned on who owned the right to the privileged information after the merger.

In light of *Great Hill*, attorneys representing clients in mergers and acquisitions should be aware of the risk that pre-merger client communications may be found to belong to the successor corporation and advise their clients accordingly.

Protecting Pre-Merger Client Communications

Under Colorado law, the attorney–client privilege of an acquired corporation generally belongs to the successor corporation subsequent to the merger.[9] The Colorado Business Corporation Act specifically provides that

> [a]ll of the rights, privileges, including specifically the attorney–client privilege, and powers of each of the merging entities . . . vest as a matter of law in the surviving entity and are thereafter the rights, privileges, powers, and property of, and obligations due to the surviving entity.[10]

At first, this principle may seem at odds with the Colorado prohibition against assigning legal malpractice claims to a stranger to the relationship, which focuses on the uniquely personal nature of the attorney–client relationship.[11] However, the policy reasons against permitting the assignment of malpractice claims may not apply when a merging party steps into the shoes of the acquired company. Indeed, some courts have recognized that an acquiring entity standing in the shoes of the former client owns, and may assert, a legal malpractice claim as part of the overall assets acquired, even where that same claim could not be assigned to a stranger.[12]

For example, the Idaho Supreme Court found that a malpractice claim may be purchased as part of a commercial transaction, along with other business assets and liabilities.[13] Even states that generally prohibit assignment of malpractice claims (e.g., Illinois) have allowed a party to acquire a claim as a result of a transfer of assets in a merger.[14]

Some courts have reached the opposite conclusion. For example, in 2013, the Washington Court of Appeals found that an adversary acquiring its opponent could not circumvent the anti-assignment prohibition.[15]

Risk Mitigation

Given this uncertainty, corporate mergers and acquisitions attorneys can address these risks in three ways.

First, attorneys can warn their clients that the successor entity might be entitled to discover the content of all pre-merger privileged communications. As explained above, in Colorado the privilege belongs to the successor corporation by statute. Attorneys should provide written notice of this risk in the engagement letter or fee agreement, or in separate correspondence dedicated to addressing the risks and exposures of the transaction.

Second, attorneys can address the risk in the nondisclosure documents associated with the transaction through a provision specifying that all pre-merger communications will remain privileged, with a proviso that the limitation will survive the closing on the transaction.

Third, the issue can be addressed by agreement in the transaction documents themselves, as the court suggested in *Great Hill*. In that case, although the court found the statute governing asset transfers to be unambiguous,[16] it acknowledged the parties' "contractual freedom" to decide the terms of their agreement.[17] Because the transaction documents in *Great Hill* were silent on the privilege issue, the court held that the statute controlled.[18]

The holding in *Great Hill* encourages parties to address the issue up-front. If a corporate client wishes to retain the attorney–client privilege following a merger in which the corporation is to be acquired, it can negotiate such a provision.

Conclusion

In mergers and acquisitions, the attorney–client privilege is often treated as a corporate asset. Parties to the transaction can protect this asset in several ways. However, in Colorado, if the parties do not expressly agree regarding the post-merger ownership of the privilege, the privilege will belong to the successor corporation by statute. Accordingly, it is critical that attorneys advising corporate clients in mergers and acquisitions consider this risk, warn their clients, and seek to protect the privilege by, among other things, attempting to negotiate a provision that the privilege will remain with the acquired company.

Notes

1. *Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981) (finding that the attorney–client privilege applies when the client is a corporation); *Roe v. Catholic Health Initiatives Colo.*, 281 F.R.D. 632, 635 (D.Colo. 2012) (quoting *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 348 (1985) ("The administration of the attorney–client privilege in the case of corporations, however, presents special problems. As an inanimate entity, a corporation must act through agents.")).

2. Balotti and Finkelstein, *Delaware Law of Corporations and Business Organizations* § 21.1 (Wolters Kluwer, 3d ed. Supp. 2016) ("Delaware has long been the forum of choice of the organization of corporations.").

3. *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 80 A.3d 155 (Del.Ch. 2013).

4. *Id.* at 156.

5. *Id.* at 162.

6. *Id.* at 156 n.3 (quoting 8 Del.C. § 259). While Colorado courts have not expressly addressed which party to a merger owns the privilege attached to pre-merger client communications, the Colorado Business Corporation Act contains language similar to the provision on which the *Great Hill* court relied. CRS § 7-90-204(1)(a). This suggests it is likely that Colorado courts would hold similarly if faced with this question.

7. *See, e.g.*, *Weintraub*, 471 U.S. at 352.

8. *See FDIC v. McAtee*, 124 F.R.D. 662, 664 (D.Kan. 1988) (holding FDIC as receiver not authorized to waive attorney–client privilege of former bank); *cf. Odmark v. Westside Bancorporation, Inc.*, 636 F.Supp. 552, 556–57 (W.D. Wash. 1986) ("[T]he court concludes that FSLIC is the exclusive holder of the attorney–client privilege between Westside and the Firm.").

9. CRS § 7-90-204(1)(a).

10. *Id.*

11. *See Roberts v. Holland & Hart*, 857 P.2d 492, 495–96 (Colo.App. 1993).

12. *See, e.g.*, *Richter v. Analex Corp.*, 940 F.Supp. 353, 357–58 (D.D.C. 1996); *White Mountains Reinsurance Co. of Am. v. Borton Petrini, LLP*, 221 Cal.App. 4th 890, 909 (2013); *Hedlund Mfg. Co. v. Weiser*, 539 A.2d 357, 359 (Pa. 1988); *Cerberus Partners, L.P. v. Gadsby & Hannah*, 728 A.2d 1057, 1061 (R.I. 1999).

13. *See St. Luke's Magic Valley Reg'l Med. Ctr. v. Luciani*, 293 P.3d 661, 665 (Idaho 2013).

14. *See Learning Curve Int'l, Inc. v. Seyfarth Shaw LLP*, 911 N.E.2d 1073, 1081–82 (Ill.App.Ct. 2009).

15. *See Kenco Enters. Nw., LLC v. Wiese*, 291 P.3d 261, 265 (Wash.Ct.App. 2013).

16. *Great Hill*, 80 A.3d at 159.

17. *Id.* at 161.

18. *Id.* at 159. ■