

# Clients & Friends Alert

## Chancery Court Takes Firm Stance on Seller's Pre-Closing Privileged Communications

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A recent Delaware Chancery Court opinion highlights the risk to sellers and their advisors that pre-closing communications could become evidence in a post-closing lawsuit related to the transaction. The opinion, *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, provides a number of important lessons on merger agreement drafting and post-closing conduct, particularly in transactions involving private targets.

### Background

The case involves a merger between the target, Plimus, Inc., and a buying consortium led by Great Hill. As a result of the merger, Plimus became a subsidiary of the buyers. One year after the merger was consummated, in September 2012, the buyers sued the sellers on the ground that they fraudulently induced the buyers into the acquisition.

The buyers' claim was based in part on communications between Plimus and its deal counsel, which remained on Plimus' computer systems following the merger. Sellers argued that they retained control of the attorney-client privilege over these communications post-closing and that the communications could not be used in the lawsuit absent the sellers' waiver of the privilege. The buyers countered that the communications and the privilege itself were part of the assets acquired in the merger.

### Decision

The Delaware Chancery Court decided the privilege issue in favor of the buyers. Chancellor Strine relied on the Delaware merger statute, which provided that following a merger, "all property, rights, [and] privileges . . ." become the property of the surviving corporation. To the Chancellor, "all" meant "all," in plain English, including privileges.

The court observed that sellers have a way to protect themselves in this situation. Sellers can negotiate provisions in a merger agreement to prevent certain aspects of the privilege and pre-merger communications from transferring to the surviving corporation in the merger.

The court did not decide the buyers' alternative argument that the sellers had waived any privilege they did retain. While not deciding the waiver issue, the court observed that the sellers failed to negotiate a merger agreement provision preserving the privilege for themselves and waited one year post-closing before asserting a right to the privilege while failing to remove the information from the system prior to closing.

### Takeaways

The *Great Hill* decision highlights several important considerations for sellers and buyers in negotiating a merger agreement for the sale or acquisition of a private company.

Sellers should:

- Include in the merger agreement specific language to retain ownership of privileged and non-privileged communications, including communications relating to the deal. Consider addressing the issue in advance if an organized sales process will be conducted.
- Take care with written communications relating to the deal, recognizing that pre-closing communications may become the subject of a post-closing dispute.
- Take steps pre-closing to remove from computer systems being transferred to the buyer any communications that may properly be retained by sellers under the merger agreement.
- Post-closing, if the privilege is retained, ensure that relevant communications are protected and the privilege is not waived.

Buyers should:

- Consider the value of acquiring the seller's deal-related communications and control of related privileges.
- Recognize that attempting to reserve claims against sellers based on pre-closing attorney-client communications is likely to be an uphill battle and, if insisted on by buyers, could impact the merger consideration (i.e., it may cost more to acquire control of the relevant privileges and communications).

- Specifically define the scope of any retained privilege so that communications between the target and its counsel that are not related to the deal (such as communications with non-deal counsel) are transferred to buyer.
- Retain the right to control the privilege in post-closing disputes with third-parties and regulators.

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