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Preserving the Attorney-Client Privilege in M&A Transactions

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Mergers and acquisitions are susceptible to litigation. Minority shareholders, unhappy with the effect of the deal on their stake in the company, often argue that the transaction was unfair to them, either in form or substance. Whether their argument is simply a petty dispute or develops into full-blown litigation, it behooves the company to be in a position to control the evidence which is used against it. Once the litigation process starts, it is the evidence, as opposed to the facts in the abstract, that will matter.

Unfortunately, the attorney-client privilege is an evidentiary issue which is often an afterthought in M&A deals. With the rise of electronic discovery and the general preservation of electronic communications, such non-planning can be dangerous, and new best practices need to be developed. If it is understood, preliminary measures can be put in place advantageously.

In general, the attorney-client privilege protects communications which are made between an attorney and a client (or potential client) for the purpose of seeking legal advice. Preserving the privilege will prevent disclosure of the privileged communication which can be advantageous in litigation. However, the privilege can be lost if the communication is made in the presence of, or is subsequently relayed to, others who are not necessary for the rendering of such legal advice.

Straightforward as it seems, the privilege does not necessarily fit nicely into the reality of attorney-client relations in an M&A deal. For example, the privilege protects only legal advice, not business or personal advice, although an attorney will often discuss or negotiate both legal and business points throughout a transaction. Similarly, the privilege is lost where the communication is made in the presence of others, and most discussions or negotiations relating to any M&A deal are conducted between multiple parties (*i.e.*, investment bankers, accountants, etc.). As an illustration, in a Delaware case, whether the privilege was available turned on the fact that the investment bankers on the deal had been copied on the email in question. In short, the reality of the deal context makes it difficult to preserve the attorney-client privilege.

A further complicating factor is which jurisdiction's attorney-client privilege law applies. Although the privilege is a basic concept, there can be varying nuances between states. Many states use the "most significant relationship" test to determine which state's privilege law applies. This test provides that the laws of the "state which has the most significant relationship to a communication" will be applied. In an M&A deal, it is common for communications to transcend state borders, and therefore difficult to determine which state had the most significant relationship to a particular communication.

Despite the unnatural application of the privilege in the M&A context, there is one deal-feature which may lend itself nicely to the privilege – that is the ability to control the privilege post-transaction. The privilege may be asserted only by the holder of the privilege (or by his/her/its attorney). Who holds the privilege post-transaction will depend on the form of the transaction. For example, in the case of an asset sale, where the company sells assets but the entity remains, the attorney-client privilege will remain with the company that sold its assets. By contrast, in the case of a stock sale, where the entity remains but new ownership comes in, the attorney-client privilege will remain with the client company, despite the change in ownership, even for communications which occurred post-transaction. This is the case because throughout the deal process, communications between the attorney and the entity-client will be with the company's management. Although these communications are with a natural person, because management is deemed to be acting on behalf of its employer entity, any such communications will be a privilege of the entity, not of the individual himself/herself. While the form of the transaction is typically driven by other factors, such as tax considerations, M&A attorneys and their clients are well served to understand the consequences the form of the transaction will have upon the ability to assert the privilege post-transaction.

One more point. In the case of a stock sale, the transfer of the attorney-client privilege can allow the acquiror to pursue pre-existing rights or defend pre-existing liabilities for the benefit of the company. While this is a desirable result to the acquiror, this also gives the acquiror the ability to waive the attorney-client privilege for any communications made before the transaction, a potentially undesirable result for the pre-transaction management who actually made the communications. This potential outcome can be avoided by an agreement with successor ownership regarding special access to, or control over, certain privileged communications.

In light of the foregoing, attorneys should develop best practices with regard to the nuances of the attorney-client privilege as applied to the M&A context. Their clients should be aware of these best practices. Suggestions include:

- Set expectations at the beginning of the transaction process. Explain that a communication to or from an attorney is not protected merely by virtue of being to or from an attorney. The communication must be made for the purpose of giving or receiving legal advice outside of the presence of others.
- Attempt to delineate business communications from legal communications. Where a document contains both privileged and non-privileged information, the document will need to be produced in response to a discovery request, with only those legal portions redacted.
- Remind clients and the client's management team that email and other electronic communications are routinely retained by computer systems or other recipients. Such communications are generally the primary target of discovery by a company's adversary.
- Be aware of which states' privilege law may apply. The attorney-client privilege may have varying nuances depending on the jurisdiction.
- Use caution in considering who is copied on emails and other communications. In particular, limit the communication of legal advice to only those who are necessary for the rendering of such advice. In some states, even using an email account that does not belong to the company client can lead to waiver.
- Be aware of the different ways the client can waive the attorney-client privilege. For example, forwarding an email or discussing the points of the transaction outside of the client company.
- Be aware of the effect that the form of the transaction will have on the attorney-client privilege, and plan accordingly.

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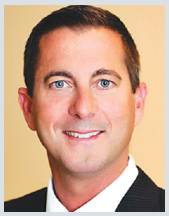

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