DELAWARE CORPORATE LAW BULLETIN

Chancery Court Finds Merger Agreement Preserved Sellers' Privilege Over Pre-Merger Attorney-Client Communications

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Also rejects buyers' argument that post-closing conduct of sellers' representative effectively waived the privilege in connection with post-closing litigation between the parties

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INTRODUCTION

Parties to a merger naturally retain individual legal counsel throughout the process. By operation of the merger statute, when the transaction closes all assets of each constituent corporation to the merger become assets of the surviving corporation. These days, surviving corporation assets generally include computers and servers replete with privileged communications between the target company and its attorneys. If post-closing litigation arises between the parties, the buyer's possession of privileged pre-merger communications between the target company and its attorneys regarding the transaction can create a delicate situation. Addressing this tension in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 80 A.3d 155 (Del. Ch. 2013) ("*Great Hill*"), the Delaware Court of Chancery (the "*Chancery Court*") held that those sensitive pre-merger attorney-client communications pass to the buyer at closing along with the target's other assets. In so ruling, however, then-Chancellor Leo E. Strine Jr. advised future target corporations to use their freedom of contract to preserve the privilege post-closing.

The Chancery Court addressed this exact situation in *Shareholder Representative Services LLC v. RSI Holdco*, *LLC*, C.A. No. 2018-0517-KSJM, 2019 WL 2290916 (Del. Ch. May 29, 2019) ("*Shareholder Services*"). Unlike in *Great Hill*, the target company in *Shareholder Services* presciently preserved in the merger agreement the privilege over its pre-merger attorney communications in case of post-closing litigation. When litigation arose, the buyer contended it could use these communications, in the form of emails, notwithstanding the merger agreement, because the target company and the representative of the target's owners allegedly waived privilege. Vice Chancellor Kathaleen St. J. McCormick, following Chancellor Strine's reasoning in *Great Hill*, granted the representative's request for a protective order.

I. FACTUAL BACKGROUND

Radixx Solutions International, Inc. ("*Target*") specializes in developing cloud-based software utilized by the airlines industry. In September 2016, private equity firm TA Associates, through its affiliate RSI Holdco, LLC (together "*Buyers*"), acquired Target in a merger effected pursuant to an Agreement and Plan of Merger ("*Merger Agreement*"). The Merger Agreement appointed Shareholder Representative Services LLC ("*Representative*") to represent Target's former stockholders if post-closing disputes arose. Target retained the

Seyfarth Shaw LLP law firm ("*Seyfarth*") for representation in the merger. At closing, by virtue of the merger, Buyers gained ownership of Target computers and email servers containing "approximately 1,200 pre-merger emails" between Target and Seyfarth. These emails were protected by attorney-client privilege when communicated, but "were not excised or segregated from [Target's] other communications at the time the merger closed."

On May 9, 2018, in connection with attempts to resolve disputes over post-closing purchase price adjustments, Buyers informed Representative they had discovered the Seyfarth emails and asserted privilege over them had been waived. Representative responded on May 14th, pointing out that Section 13.12 of the Merger Agreement preserved privilege and, accordingly, Buyers must refrain from reviewing the emails. Two days later, Buyers reasserted privilege had been waived.

Then, on July 17th, Representative brought an action in the Chancery Court alleging Buyers breached the Merger Agreement by failing to repay an amount held back from the purchase price. On November 9th, Buyers filed a Motion for Disposition of Privilege Dispute asking the Chancery Court for "full, unfettered access" to Target's pre-closing emails with Seyfarth for use in the litigation. In response, Representative cross-moved for a protective order to prevent Buyers from using the emails in the litigation, relying on four provisions in Section 13.12 of the Merger Agreement purporting to preserve pre-closing privilege:

(1) Any privilege resulting from Seyfarth representing Target in connection with the merger "shall survive the [merger's] Closing and shall remain in effect;"

(2) Such privilege "shall be assigned to and controlled by" Representative;

(3) In furtherance of the foregoing, "each of the parties hereto agrees to take the steps necessary to ensure that any privilege attaching as a result of [Seyfarth] representing [Target] . . . in connection with the transactions . . . shall survive the Closing, remain in effect and be assigned to and controlled by" Representative; and

(4) "As to any privileged attorney client communications between [Seyfarth] and [Target] prior to the Closing Date," the parties "agree that no such party may use or rely on any

> of the Privileged Communications in any action or claim against or involving any of the parties hereto after the Closing."

II. VICE CHANCELLOR MCCORMICK'S ANALYSIS

A. Great Hill Requires that Targets Contract to Preserve Privilege

Vice Chancellor McCormick began her analysis by revisiting *Great Hill*. In *Great Hill*, the parties failed to carve out language in the merger agreement to preserve privilege over pre-merger attorney-client communications. Chancellor Strine held "that 'the merger was intended to have the effects set forth in' " § 259 of the Delaware General Corporation Law ("*DGCL*"), which provides 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" (emphasis added). Chancellor Strine, reasoning that " 'privileges' included evidentiary privileges over attorney-client communications," opined "that absent 'an express carve-out, the privilege over all pre-merger communications—including those relating to the negotiation of the merger itself—passed to the surviving corporation in the merger . . . .' " In so ruling, he warned future sellers wishing to assert privilege over pre-merger attorney communications to "use their contractual freedom . . . to exclude from the transferred assets the attorney-client communications they wish to retain as their own."

B. Target Followed Chancellor Strine's Advice

Relying on *Great Hill*, Vice Chancellor McCormick granted Target's motion for a protective order on the basis that it used its "contractual freedom to secure Section 13.12 of the Merger Agreement." The Vice Chancellor pointed to Section 13.12's "plain and broad language" preserving privilege over the pre-merger emails with Seyfarth and assigning control over the privilege to Representative post-closing. Further, she recognized this language contained a "no-use" clause prohibiting Buyers from using privileged communications with Seyfarth in post-closing litigation with Target, "exactly" what they asked the Vice Chancellor to sanction in their Motion for Disposition of Privilege Dispute.

Buyers responded with two arguments: (1) Section 13.12 did not apply to the Seyfarth communications, and (2) even if it did, the

communications were not immune from subsequent waiver. The Vice Chancellor rejected these arguments in turn.

First, Buyers argued Section 13.12's "no-use" clause applied only to "privileged communications," and the Seyfarth emails "are not privileged *at this point in time* because any privilege was long ago waived" by Representative's post-closing conduct on behalf of Target's former stockholders. Vice Chancellor McCormick rejected this position as "contrary to the express language of Section 13.12 of the Merger Agreement." For purposes of Delaware law, "if the relevant contract language is clear and unambiguous, courts must give the language its plain meaning." Because Buyers did not contest that the communications with Seyfarth were privileged "as of the closing date," their waiver argument rested on "post-closing conduct." As such, Buyer's first argument could not overcome "the plain language of Section 13.12."

Second, Buyers argued privilege over pre-merger communications can be waived *post-closing* despite a carve-out provision like Section 13.12. They "parrot[ed] arguments made in *Great Hill*," positing that Target's failure pre-closing "to take 'steps to segregate' or 'excise' " the Seyfarth communications from the computer systems, together with the failure on the part of Representative or the former stockholders to take actions "post-closing to 'get these computer records back,' " effectively waived privilege over these communications. Vice Chancellor McCormick was not convinced, holding "waiver would undermine the guidance of *Great Hill*—which cautioned parties to negotiate for contractual protections," and thereby "render the express language of Section 13.12 meaningless." She also found no Delaware precedent supporting Buyers' waiver theory, discounting remarks made by Chancellor Strine during oral argument in *Great Hill* as having "no precedential value in any event."

From the Vice Chancellor's perspective, the final flaw in Buyers' position was Section 13.12's direction to the parties to "take the steps necessary to ensure that any privilege attaching as a result of [Seyfarth] representing [Target] . . . in connection with the transactions contemplated by this Agreement shall survive the Closing . . . and be assigned to and controlled by" Representative. Thus, for privilege to be waived post-closing, the Vice Chancellor reasoned, "it would necessarily be due in part to [Buyers'] own failure to 'take the steps necessary' to preserve it." The Vice Chancellor would not permit Buyers' "own failure to preserve privilege [to] now inure to [their] benefit."

CONCLUSION

Vice Chancellor McCormick's decision in *Shareholder Services* gives effect to Chancellor Strine's advice in *Great Hill*. Keeping with Delaware's longstanding pro-contractarian principles, the Vice Chancellor held parties can contract to preserve pre-merger privileged communications post-closing. Moreover, if the contractual language is properly crafted, arguments that a privilege so preserved is waived by post-closing conduct will fall on deaf ears. Presumably this approach pertains to acquisitions via stock purchase as well as to mergers. Thus, going forward, target company owners seeking to prevent buyers from using pre-acquisition target company attorney communications in post-closing litigation must include language in their acquisition agreements to clearly extend privilege after closing and to assign that privilege to the owners or their representatives.