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A Guide to Attorney-Client Privilege in Private Equity Transactions

Best practices to guard against waiver of the attorney-client privilege pre- and post-merger and acquisition.

By Andrew Balthazor, Jose Casal, and Matthew Grosack – June 21, 2021

Private equity acquisitions, divestures, and the relationships between the fund and the portfolio are all affected by concerns of unintentional waiver of privileged communications. Deal-centric waiver disputes implicate the acquisition's structure, rollover status, and potentially applicable statutory law. Attorney-client privilege considerations arise even after closing, as key players may maintain positions with access to privileged information across multiple organizations—raising the specter of a privilege waiver if that information is shared outside its privileged context. This article analyzes issues of privilege and waiver, both during and after the acquisition, and suggests best practices to ensure attorneys and their clients guard against waiver of privilege in these circumstances.

Transactional Considerations

In *Great Hill Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, the Delaware Chancery Court began what would be an enlightening judicial discourse about privilege concerns and waiver in the mergers and acquisitions context. There, the court addressed the issue of privilege waiver in a merger transaction regarding the selling company's pre-closing attorney-client-privileged communications that transferred to the buyer after closing. The court relied on Delaware General Corporation Law section 259 in holding 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," by "plain operation" of Delaware statutory law. *Great Hill Partners IV*, 80 A.3d 115, 162 (Del. Ch. Nov. 15, 2013). As then chancellor Strine explained, "the answer to any parties worried about facing this predicament in the future is to use their contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own." *Id.* at 161. The principles governing privilege and waiver in *Great Hills* were later reinforced by other Delaware decisions, such as *Shareholder Representative Services LLC v. RSI Holdco*, 2019 WL 2290916 (Del. Ch. May 29, 2019). But *Great Hill* involved a merger in which one of the transacting corporations ceased to exist after closing. Do the dynamics and rules change in the context of an asset transaction?

According to vice Chancellor Zurn, it would appear so. In *DLO Enterprises, Inc. v. Innovative Chemical Products Group, LLC*, Vice Chancellor Zurn addressed similar tranches of documents

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as in *Great Hill*—pre-closing communications between sellers and their counsel. One category of documents (referred to as Category One in the decision) concerned pre-closing communications between sellers and counsel produced to the buyer in redacted form, and the other category of documents (referred to as Category Two) were similar documents left on buyer's email accounts that included both pre- and post-closing communications. The buyer sought the production of unredacted versions of Category One and argued that the sellers had waived privilege with respect to Category Two.

With respect to Category One, "the parties dispute[d] whether in the Purchase Agreement or by operation of law, Buyers purchased the right to waive Sellers' privilege over pre-close deal communications." *DLO Enterprises, Inc.*, 2020 WL 2844497, at *3. In addressing Category One, the court distinguished *Great Hill* and held that the court's section 259 interpretation did not apply to an asset purchase. The court stated that mergers are governed by statutes that automatically transfer all privileges and that mergers "are distinct from asset purchase transactions governed by agreements." *Id.* at *4. The court discussed the distinguishing characteristics of an asset deal, stating that "the selling entity is not extinguished by or subsumed within the purchasing entity" and "still exists, holding any assets that were not purchased, together with related privileges." *Id*. at *5. With respect to Category One, the court concluded that "[p]rivilege regarding an asset purchase agreement and associated negotiations does not pass to the purchaser by the default operation of any law, but rather, remains with the seller unless the buyer contracts for something different," and that "parties must explicitly bargain for a deviation from the baseline rule governing pre-closing privilege." *Id.*

The court addressed Category Two documents in a different manner. For post-closing emails, the court assessed whether the seller—then an employee of the newly formed buyer company—had a reasonable expectation of privacy in work email, and the court found, among other things, that the buyer's expectations were not reasonable under the circumstances. The court noted that this analysis could be subject to a "statutory override" if the controlling jurisdiction has a statute on the confidentiality of work emails. As to pre-closing emails, the court also considered the seller's expectation of privacy but indicated that "the proper test may be one of inadvertent production, rather than solely a consideration of . . . expectation of privacy when working for the Target" and a consideration of "who holds the privilege over the communications." *Id.* at *10. While the court requested that the parties more fully brief the issue, it noted that "[s]ellers may hold the privilege over the . . . emails, such that Target's access to the . . . emails would not destroy any relevant confidentiality." *Id.*

The lesson of both *Great Hills* and *DLO* is this: Regarding privilege ownership and waiver, parties will be subject to already-established facts in the absence of clear statutory authority or purposeful deal drafting. It is thus prudent to address the following issues prior to closing:

- In an asset purchase, among other things, is the privilege sufficiently articulated as an excluded asset and how is the issue of waiver (and the right to waive privilege) addressed?

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- In the merger context, should the privilege be transferred away from the surviving corporation to a separate sell-side entity; and, in the context of multiple former target shareholders, should a separate single entity or a shareholders' representative be considered as the owner of the privilege post transaction?
- In a world where privileged information may (and almost surely does) exist digitally on servers and other electronic assets, have considerations of claw-back and non-waiver language been included in the transactional documents?
- To the extent the issue cannot be drafted for in the merger context, additional measures such as a common interest agreement limiting the permitted uses of transferred digital information and the quarantining of potentially privileged information could be considered.

Post-Closing Portfolio Considerations

After closing, private equity purchasers should also be mindful of privilege concerns when communicating with the broader portfolio. Special attention should be paid to the dual-hat situation of a private equity partner or director who maintains a board seat at the portfolio level.

For example, *Argos Holdings Inc. v. Wilmington Trust National Ass'n*, No. 18CV5773(DLC), 2019 WL 1397150 (S.D.N.Y. Mar. 28, 2019), involved a private equity firm's acquisition of a portfolio company. Three individuals were partners and directors within the private equity firm, and the same persons were also serving as officers and directors of the portfolio company. Separate legal firms represented the fund and the portfolio company. A dispute with a third party arose regarding whether the portfolio company had waived attorney-client privilege as to certain communications and documents by sharing confidential information with the three portfolio company directors who also had roles within the separate investor entities.

The *Argos Holdings* court found that privilege is preserved only if a person receiving a confidential communication is doing so *within the capacity that entitles the communications to be privileged*. The court then examined several factors to determine whether the communications were made to the persons within their roles as portfolio company directors:

- whether the communications were made to the entire portfolio company board or just to the three persons serving as designated directors of the private equity firm;
- language indicating within what capacity a person was being sent communications;
- whether emails were sent to persons using email addresses external to the portfolio company; and
- indicia that the communications would remain confidential to the directors and not shared with persons in the separate investor entities.

The court weighed the above factors and held that privilege was waived as to certain communications because there was no evidence that the information was shared with persons in their capacity as portfolio company directors.

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At the portfolio level, individuals wearing the dual hat of fund partner and portfolio board member can consider multiple strategies for ensuring the protection of privileged information: (i) extending the privilege, including all appropriate entities under an expanded privilege umbrella; and (ii) preventing privilege waiver by implementing certain practices by attorneys and clients.

In certain scenarios, it will be possible to expand the privilege to cover all necessary persons who need access to confidential information. Here, there are two approaches: (1) joint representations and (2) relying on the common interest doctrine and the execution of a common interest agreement. The context of a particular attorney-client relationship will define to what extent either option is available. Having attorneys enter into co-representation or joint representation agreements with all entities—private equity firms and their portfolio companies—is the one way to protect communications involving persons who have multiple roles spanning separate organizations. Such an agreement should identify the clients at issue and the clients' common interests relating to the representation—stated as broadly as possible. Only communications related to the representation are privileged; the definition of the representation's scope should be expansive.

Generally, joint clients may not waive privilege without the consent of the others. Even accidental waiver by one client has no bearing on other clients' ability to assert the privilege. However, a joint client may waive the privilege unilaterally if the joint clients become adversaries in litigation relating to the joint representation itself.

Joint representation is not always possible due to conflicts or certain business considerations—such as when a portfolio company is only partially owned by an investor entity and the other investors wish to retain separate portfolio company legal representation. Finally, co-clients in a joint representation may not assert the privilege against one another; if any entity desires to retain this option, a joint representation agreement would be inappropriate.

If co-representation is not possible, a common legal interest shared among entities will extend the privilege to shared communications relating to that interest—albeit with more restrictions than in a joint representation.

First, the common interest doctrine is not an independent source of privilege, unlike a joint representation agreement with an attorney. *United States v. Schwimmer*, 892 F.2d 237, 243 (2d Cir. 1989). Unprivileged information that is simply shared among commonly interested parties will not be protected. But otherwise-privileged communications furthering a common legal interest will preserve their privileged character.

Secondly, there must be a common legal interest: a shared interest in a potential dispute, concerns about possible litigation that could involve the parties' interests, or shared property interests that may be subject to litigation. *Schaeffler v. United States*, 806 F.3d 34, 40–41 (2d Cir. 2015). "It does not, however, 'encompass a joint business strategy which happens to include as one of its elements a concern about litigation.'" *HSH Nordbank AG N.Y. Branch v.*

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Swerdlow, 259 F.R.D. 64, 71 (S.D.N.Y. 2009) (quoting *Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.*, 160 F.R.D. 437, 447 (S.D.N.Y. 1995)).

Showing a common legal interest is done by a executing a common interest agreement or a joint defense agreement or is implied by the circumstances. An explicit joint defense agreement is the best practice, but a joint defense agreement may be implied by the parties cooperating in obtaining legal assistance relating to their common interests. And in certain situations, a court may find that a common legal interest exists based on the circumstances, even in the absence of litigation and without an implied joint defense agreement. Here, courts tend to look at whether the two entities have identical interests in a subject. *SecurityPoint Holdings, Inc. v. United States*, No. 11-268C, 2019 WL 1751194, at *2 (Fed. Cl. Apr. 16, 2019). For example, an equity investor and its portfolio company share interests in protecting the value of the portfolio company's assets. This occurs most frequently regarding intellectual property but could apply to protecting other company assets.

Jurisdictional-specific rules further constrain the application of the common interest doctrine. While a complete state survey of the rules is beyond the scope of this article, two jurisdictional limitations warrant emphasis:

- **Delaware.** The common interest doctrine protects only information shared with or between attorneys representing clients with a common legal interest. Del. R. Evid. 502(b). Communication between non-attorneys sharing a common interest will not remain privileged.
- **New York.** The common interest doctrine applies only to pending or anticipated litigation. *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, 57 N.E.3d 30, 38 (N.Y. 2016).

Thus, it is important to review the common interest doctrine's constraints within applicable jurisdictions before considering this option to extend privilege to confidential communications. The party asserting privilege has the burden to show that the communications were shared only with those entitled to the privileged communications.

Best Practices Drawn from *Argos Holdings*

Using the *Argos Holdings* court's factual considerations as a guide, the following is a list of practices attorneys and their clients can implement to preserve attorney-client privilege in the private equity and portfolio company context:

- Create a policy that privileged information be shared with all relevant decision-makers. For example, information goes to the entire board of directors. Avoid selective sharing.
- If sharing information with a subset of decision-makers, require that the subset be logically related to the business purposes of the entity seeking to preserve privilege.
- Create organizational email addresses for directors and others as needed. Include electronic signatures that indicate a person's role within the organization.

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- Maintain separate emails for directors and fund personnel who wear multiple hats.
- Require that internal email addresses be used for all organizational communications. Prohibit the use of external email for company business.
- Prohibit the sharing of privileged information with external persons or organizations, even if a director or officer belongs to multiple organizations.
- Identify privileged communications by using tags, flags, categories, or labels—as opposed to a general disclosure that is included on all emails. Require the use of this identification method.
- Require a consistent email subject heading that makes it clear the communication is privileged. For example, all privileged emails must begin with "[Privileged]" or "[P]."
- Segregate privileged documents, and mandate that they not be stored on external servers or personal computers, reducing the risk of commingling files and potentially exposing privileged documents to external organizations and unintentional waiver.
- Implement information technology policies preventing devices that access multiple email accounts—such as mobile phones and tablets—from being able to share emails or files between different organizations. Require that these policies be used on any devices used by persons with access to an organization's communications or files.
- Require training on the organization's confidentiality protocols, and document the attendance of key "at risk" multi-role individuals.

Conclusion

An active private equity fund will face the issue of privilege waiver during organizational friction points, including during investment, divesture, and even day-to-day portfolio management (assuming private equity partners wear multiple hats). In connection with the transaction, specific attention should be paid to the type of the transaction (merger versus asset) and what language or mechanisms can be considered to address the ownership of privilege and potential waiver issues. At the portfolio level, persons serving in multiple capacities across disparate organizations pose a risk of waiving privilege in attempting to serve in their different capacities—capacities that do not always have the same entitlements to privileged communications. Expanding the reach of the attorney-client privilege via joint representation agreements or identifying a common legal interest can enlarge the privilege's scope. And implementing certain organizational procedures will better equip a party to show that it preserved the attorney-client privilege in the event it is necessary to protect communications and documents from disclosure.

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