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Reasonable Best Efforts: Cold Comfort to Sellers

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On November 8, 2013, Vice Chancellor Sam Glasscock III of the Delaware Chancery Court issued a preliminary bench ruling in the matter of *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., et al.*[1], refusing Cooper Tire's request that the Court require Apollo to use its reasonable best efforts to complete negotiations with Cooper Tire's union and immediately close the merger of Cooper Tire and Apollo. This case's colorful fact pattern has garnered significant attention. More significantly, it provides a rare Delaware court interpretation of the actions required to satisfy the "reasonable best efforts" standard that has become commonplace in antitrust covenants in merger agreements. While this standard is used frequently and is often the subject of bitter dispute in negotiations, lawyers are hard pressed to tell their clients what actions this standard requires. Sellers have sometimes relied on this standard, believing it to provide some closing certainty regarding regulatory and third-party approvals in transactions where specific divestiture commitments, reverse termination fees or other antitrust risk-shifting provisions have not been used. This appears unwise in light of *Cooper*: a reasonable best efforts standard alone provides cold comfort to sellers seeking deal certainty in circumstances where there is a meaningful likelihood that the antitrust authorities will require economic concessions in order to approve a transaction.[2]

Background: You Can't Make This Stuff Up

On June 12, 2013, Apollo Tyres ("Apollo"), an Indian company, agreed to acquire Cooper Tire & Rubber Co. ("Cooper") for $35 per share pursuant to a long-form merger valued at approximately $2.5 billion in the aggregate. Apollo was financing the transaction through, among other facilities, a $1.875 billion bridge to bond facility. Although the drop-dead date for the transaction was December 31, 2013, the closing of the transaction was anticipated

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Let the Seller Beware: The Seller's Attorney-Client Privilege Passes to Surviving Corporation in a Merger Under Delaware Law

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In a case of first impression under Delaware law, the Delaware Court of Chancery recently held that control of the attorney-client privilege of the target corporation passes to the acquiror in a merger.[1] As a result, neither the target nor its principals may assert privilege over merger-related communications with the target's deal counsel in a post-closing dispute. Notably, this rule conflicts with the one adopted by the New York Court of Appeals nearly two decades ago.[2] Importantly, however, it is a default rule, and merging parties are free to contract around it.

This article first discusses the transactional background of *Great Hill* and briefly analyzes the decision. Next, it highlights some of the transaction-planning and drafting issues that *Great Hill* brings to the fore.

Factual Background of *Great Hill*

The privilege dispute in *Great Hill* arose in the context of the acquisition of Plimus, Inc., a venture-backed payments processing company. Plimus was sold for $115 million to affiliates of Great Hill Equity Partners, a Boston-based private equity firm. The parties structured the deal as a reverse triangular merger through which Plimus would become a wholly-owned subsidiary of a Great Hill acquisition vehicle.[3] Approximately one year after the merger, Great Hill sued the selling stockholders and their representative, claiming that the sellers had made fraudulent misrepresentations in connection with the merger concerning the health of the business.

When Great Hill was preparing its complaint, it discovered that its computer system, which formerly belonged to Plimus and had been used by the sellers, contained merger-related communications between and among the sellers and their counsel. Great Hill promptly informed the sellers about these documents to allow the sellers to assert privilege, which they did. Great Hill maintained that it had acquired Plimus and, with it, control of the corporation's privilege.

The Court of Chancery's Opinion

In a terse opinion, Chancellor Leo E. Strine, Jr. agreed with Great Hill, and resolved the privilege dispute as a matter of statutory interpretation. Section 259 of the Delaware General Corporation Law, which dictates the legal consequences of a merger, provides that "all property, rights, privileges, powers and franchises, and all and every other interest" of the constituent corporations "shall be thereafter as effectually the property of the surviving or resulting corporation" following a merger.[4] The Chancellor concluded that the phrase "all . . . privileges" of the pre-merger target corporation inescapably includes the attorney-client privilege. The attorney-client privilege of pre-merger Plimus, therefore, vested in post-merger Plimus as the surviving corporation in the reverse triangular merger. And, control of Plimus—and with it, effective control of its pre-merger privilege—passed from the sellers to Great Hill in the merger.[5]

As the Court of Chancery ruled, the plain and unambiguous statutory language of Section 259 forecloses any" judicial improvisation,"[6] and therefore defeats the policy-based argument, advanced by the defendants, that sellers should retain control of some or all of their pre-merger privilege. By confining its decision to the language of the statute, the Court avoided having to confront the policy issues that led the New York Court of Appeals to reach a very different outcome in a very similar context.

Just like *Great Hill*, the leading New York case, *Tekni-Plex v. Meyner and Landis*, also involved misrepresentation claims made by the buyer against the seller in the acquisition of a private corporation. The privilege dispute arose in an arbitration proceeding instituted by the surviving corporation against the target's sole former stockholder. Although the court recognized that the target's privilege generally vested in the surviving corporation in the merger,[7] the court created a policy-based exception for merger-related communications. As stated by the Court of Appeals, "corporate actors should not have to worry that their privileged communications with counsel concerning the [merger] negotiations might be available to the buyer for use against the sold corporation in any ensuing litigation."[8] This concern, the court reasoned, "would significantly chill attorney-client communication during the transaction."[9]

How Sellers Can and Should Protect Their Privileges in a Merger

If one subscribes to the *Tekni-Plex* view as a matter of policy, *Great Hill* presents a problem. Indeed, during oral argument, the Chancellor discussed with counsel the policy issues identified by the New York Court of Appeals in *Tekni-Plex*, and appeared respectful and receptive to those kinds of arguments, absent an express statutory policy judgment.[10] But the Chancellor ultimately concluded in his written opinion that the unambiguous language of Section 259 preempted any judicial consideration of the policy issues at stake.[11]

Despite their fundamentally differing views on this issue, the New York Court of Appeals and Delaware Court of Chancery align on this critical point: Regardless of which default rule applies, the shared wishes of contracting parties will be respected and enforced. Indeed, both *Great Hill* and *Tekni-Plex* underscore the primacy of contract and, consequently, amplify the importance of careful contracting to protect the privilege.

A contractual scheme that mimics the rule established by *Tekni-Plex* should be acceptable to both sellers and buyers in many cases.

From the seller's perspective, the default rule set forth in Section 259 of the DGCL and enforced in *Great Hill* amounts to an unpalatable one-way privilege waiver,[12] and tilts the litigation playing field in the buyer's favor. A seller that fails to protect its privilege leaves itself vulnerable to a buyer trying to re-trade the deal, whether by the threat or the use of litigation, in a context—private company acquisitions—that can be fertile ground for post-closing disputes. To avoid this result, sellers should bargain for contract language protecting their transaction-related privilege and adopting the *Tekni-Plex* rule.

And from the buyer's perspective, it would be hard in many deals to articulate the business case for not allowing the seller to protect its merger-related privilege. As recognized in *Tekni-Plex*, the buyer should take ownership of the "right to invoke the [target's] pre-merger attorney-client relationship should [the buyer] have to prosecute or defend against third-party suits involving the assets, rights or liabilities that it assumed" in the merger.[13] But, as in *Tekni-Plex*, this business need can be accomplished in most cases without blighting the seller's merger-related privilege.

There are innumerable ways to accomplish the desired result. For the sake of discussion, a set of sample contract provisions appears below, based upon a review of several private company acquisition agreements:

> ***12.01 [The Sellers] retain control of the attorney-client privilege with respect to transactions contemplated by this Agreement.*** **The Parties understand and agree that [the Sellers] have been represented by [Law Firm] in connection with the transactions contemplated by this Agreement (the "Engagement"). The Parties further understand and agree that only [the Sellers] shall have the rights to control, assert, and waive the attorney-client privilege with respect to any communications at any time between or among [the Sellers] and [Law Firm] relating to the Engagement. Immediately prior to the Effective Time, all documents and communications generated and maintained by [the Sellers], the Company, and [the Law Firm] in connection with the Engagement shall become the exclusive property of [the Sellers], notwithstanding that it may inadver-**

tently come into the possession of [the Buyer] and/or the Company.

12.02 [The Sellers] may be represented by [the Law Firm] in any dispute between the Parties with respect to transactions contemplated by this Agreement. **The Parties understand and agree that [the Sellers] shall be entitled to retain [the Law Firm] as their counsel in any dispute between [the Buyer] or the Company, on the one hand, and [the Sellers], on the other, arising from or related to the transactions contemplated by this Agreement, notwithstanding [the Law Firm's] prior and/or any potential ongoing representation of the Company, and notwithstanding that the interests of [the Sellers], on the one hand, and [the Buyer] or the Company, on the other, could be directly adverse to one another. [The Buyer], Merger Sub, and the Company, and each of their affiliates and subsidiaries, agree to waive and not to assert any conflict of interest arising out of or relating to the representation, after the effective time, of [the Sellers] by [the Law Firm] in any litigation, arbitration, mediation, or other dispute resolution mechanism arising from or relating to the transactions contemplated by this Agreement.**

12.03 The Parties agree that nothing herein shall constitute a waiver of any applicable privilege. **The Parties understand and agree that nothing in this Agreement, including the foregoing provisions regarding the assertions of privilege and conflicts of interest, shall be deemed to be a waiver of any applicable attorney-client privilege. The Parties further understand and agree that the Parties have each undertaken reasonable efforts to prevent the disclosure of confidential or attorney-client privileged information. Notwithstanding those efforts, the Parties further understand and agree that the consummation of the transactions contemplated by this Agreement may result in the inadvertent disclosure of information that may be confidential and/or subject to a claim of privilege. The Parties further understand and agree that any disclosure of information that may be confidential and/or subject to a claim of privilege will not prejudice or otherwise constitute a waiver of any claim of privilege. The Parties agree to use reasonable best efforts to return promptly any inadvertently disclosed information to the appropriate party upon becoming aware of its existence.**

Again, there are infinite ways in which a given deal can be documented, and these sample provisions are presented merely to highlight the following key components that careful drafters and transaction planners should be thinking about in this setting:

- **More than just privilege could be at stake:** Although the focus of the dispute in *Great Hill* concerned the attorney-client privilege, the broad language in Section 259 of the DGCL and the Court's reasoning in *Great Hill* may be extended to encompass the attorney-client relationship more broadly defined. Sellers who are contracting to protect their privilege may also wish to include provisions that attempt to preserve their right to use their transaction counsel in the event of a dispute between the parties to the merger. This is the reason for provision 12.02 above, in which the buyer acknowledges and waives in advance the possible conflict that could arise in the event of a post-closing dispute.[14]

- **The "Engagement" between the sellers and their law firm should be broadly defined:** From the seller's perspective, the goal is to replicate the attorney-client privilege that would apply in an ordinary commercial transaction. This requires that all communications with counsel concerning the transaction be covered, and not just those that relate to specific terms of the merger agreement. The most obvious example would be counsel's advice regarding alternatives to the agreed-upon transaction that were considered by the sellers.

- **Context dictates how to define the Sellers:** The "Sellers," shown as a defined term in the

provisions above, can refer to a single selling stockholder, a group of individuals or entities, a stockholders' representative, or selected key personnel from the target corporation who take on the task of negotiating the transaction. The definition should unambiguously include all those likely to have had privileged communications with deal counsel, and should also include all those who are likely to be involved in a post-closing dispute and who should therefore take ownership of confidential communications and control of the privilege, as described in provision 12.01 above.

- **Waiver issues can present a trap for the unwary:** One consequence of the Court of Chancery's conclusion in *Great Hill* that control of the target corporation's privilege passed as a matter of law to the buyers is that it remains unclear when and if the court would find privilege to have been waived by the buyer taking physical possession of otherwise privileged information belonging to the seller. Because courts are generally reluctant to find privilege to have been waived inadvertently, parties should express their shared intent that inadvertent disclosure of otherwise privileged information is not intended to effect a waiver.

- **The inadvertent disclosure of privileged information is likely, if not inevitable:** Experienced Court of Chancery practitioners will recognize some familiar concepts from provision 12.03 above, which are borrowed from the Court of Chancery's "Quick Peek" stipulations. In a fast-moving transactional context, a robust privilege review by the seller prior to closing would be impractical and inefficient. So too in highly expedited litigation. Provision 12.03 above serves the same purpose in a transaction as a "Quick Peek" stipulation would in litigation—it allows parties to conduct a less robust privilege screen without risking a waiver of privilege in the likely event of some degree of inadvertent disclosure.

- **Establish an efficient method of preventing inadvertent disclosure:** Notwithstanding contractual protections against inadvertent waiver, the seller should also take reasonable efforts to prevent the disclosure of privileged information. One effective way to do this in many cases would be to set up a "privileged" email address early in the transaction process, and to include this address as a recipient on all deal-related communications. Then, immediately prior to closing, all emails sent to this account could be transferred from the target's computer system to the sellers', as the owners of these communications under provision 12.01 above. This is likely to be both over-inclusive and under-inclusive to some degree, depending on the email practices of the individuals involved,[15] but it would capture the bulk of information in most cases that the sellers should retain under provision 12.01.

Conclusion

To practitioners familiar with the New York law established by the Court of Appeals in *Tekni-Plex*, *Great Hill* is a surprising result. But even if *Tekni-Plex* reflects a better policy outcome, the Court of Chancery's decision gives effect to the plain language of Section 259 of the DGCL. For practitioners, the lessons from *Great Hill* are simple and straightforward, but they are important: (1) do not assume that the attorney-client privilege of a corporation will not change hands as a result of a merger; and (2) contract carefully over control of the privilege.

NOTES

1. *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 2013 WL 6037329 (Del. Ch. Nov. 15, 2013).
2. *See Tekni-Plex, Inc. v. Meyner & Landis*, 674 N.E.2d 663 (N.Y. 1996).
3. Although Plimus is a California corporation, the merger agreement expressly invoked Delaware's corporate law. *Great Hill*, 2013 WL 6037329, at *1 n.1. Section 2.02 of the Agreement and Plan of Merger provided that "[t]he Merger shall have the effects set forth in this Agreement and in the applicable provisions of the DGCL and the [CGCL]." And, Section 12.07 provided that "[a]ll disputes, controversies, issues and questions concerning the construction, validity, interpretation and enforceability of this Agreement . . .shall be governed by and construed in accordance with the Laws of the State of Delaware . . . ." The sellers apparently made no argument that the

result would be different under California law. *Id.*

4. 8 *Del. C.* § 259(a).
5. This is nothing more than a contextual application of the long established rule that "when control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well." *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 349 (1985); *see also* Paul R. Rice, Attorney-Client Privilege in the United States, § 4:20, at 4-113 (2d ed. 1999 & Supp. 2009) ("Courts universally accept the notion that the corporate board of directors and the officers to whom it delegates its management authority have both the right and the responsibility to either assert or waive the corporation's attorney-client privilege claims for the benefit of the corporation.").
6. *Great Hill*, 2013 WL 6037329, at *2.
7. *See Tekni-Plex*, 674 N.E.2d at 670 ("This conclusion comports with the new Tekni-Plex's right to invoke the pre-merger attorney-client relationship should it have to prosecute or defend against third-party suits involving the assets, rights or liabilities that it assumed from old Tekni-Plex.").
8. *Id.* at 671-72.
9. *Id.* at 672.
10. *Great Hill Equity Partners IV, L.P. v. SIG Growth Equity Fund I, LLLP*, C.A. No. 7906-CS, at 16 (Del. Ch. Oct. 15, 2013) (TRANSCRIPT) ("[I]f people want to argue about a default in the absence of a statutory default, they can argue about that. And I take Chief Judge Kaye at her point, which is that people shouldn't have to worry about this. There's enough going on in transactions, that you shouldn't have to worry about it. That's a debatable point, but it's certainly one that's a plausible point.").
11. *Great Hill*, 2013 WL 6037329, at *3 ("It would usurp the authority of our elected branches for this court to create a judicial exception to the words 'all ... privileges' for pre-merger attorney-client communications regarding the merger negotiations. That sort of micro-surgery on a clear statute is not an appropriate act for a court to take.").
12. If the buyer refuses to carve out the seller's transaction-related privilege, a seller could ameliorate the leverage-shifting effects by insisting, as a matter of fairness and symmetry, that the buyer also waive its transaction-related privilege in the merger agreement. At least this way, the post-closing litigation playing field would remain level.
13. *Tekni-Plex*, 674 N.E.2d at 670.
14. Of course, parties and their counsel should be sure to check the applicable ethical rules to see if certain conflicts of interest are, in fact, waivable in this way.
15. For example, this method will be over-inclusive in the sense that it will likely capture as privileged business-related communications between the seller and its counsel pertaining to the non-legal aspects of the transaction process. And it will be under-inclusive in the sense that it will not be perfectly followed in any case.

Delaware Vice Chancellor Provides Additional Guidance on Single-Bidder M&A Strategy

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"Enhanced scrutiny"—Delaware's intermediate standard of review first applied to a disputed sale of a company in the iconic *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[1]—requires a judicial determination that a board of directors acted "reasonably" in connection with a sale. Only then will the board be entitled to the benefits of the deferential presumption of the business judgment rule. According to a recent Court of Chancery opinion, *Revlon's* "enhanced scrutiny test…includes two key features: '(a) a judicial determination regarding the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing.'" [2]

Delaware generally has eschewed bright-line standards for establishing whether a board's actions, in the course of selling the company, withstand enhanced scrutiny. As a result, this determi-